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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SOUTHWEST CONSOLIDATED CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 19, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

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TRANSCRIPT OF RECORD

UNITED STATES CIRCUIT COURT OF APPEALS

FIFTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

SOUTHWEST CONSOLIDATED CORPORATION,

Respondent.

On Petition to Review the Decision of the United States Board of Tax Appeals

1 DOCKET NO. 93321

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,

Amended Title:

SOUTHWEST CONSOLIDATED CORPORATION
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES:

For Petitioner: Yandell Boatner, Esq.,
A. Chauncey Newlin, Esq.,
Fred Simon, Esq.,

For Respondent: Joe D. Hughes, Esq.,

DOCKET ENTRIES:

1938

May 5—Petition received and filed. Taxpayer notified. (Fee paid)

May 6—Copy of petition served on General Counsel.

June 23—Answer filed by General Counsel.

June 23—Request for Circuit hearing in Shreveport, La. filed by General Counsel.

June 29—Notice issued placing proceeding on Shreveport, La. Calendar. Copy of answer and request served.

Sept. 1[illegible]—Motion to consolidate with 94809 and 94810 filed by taxpayer. 9/21/38 granted.

Nov. 30—Hearing set Jan. 23, 1939, Shreveport, La.

Dec. 19—Notice of appearance of A. Chauncey Newlin filed.

1939

Jan. 23—Hearing had before Mr. Smith on merits. Submitted on stipulation of facts. Stipulation filed. Appearance of Fred Simon filed. Petitioner's brief due 3/25/39. Respondent's brief due 4/25/39. Reply due 5/10/39.

Feb. 7—Transcript of hearing of Jan. 23, 1939 filed.

Mar. 13—Motion to change caption filed by taxpayer.

Mar. 15—Order changing caption to read: Southwest Consolidated Corporation, entered.

Mar. 24—Brief filed by taxpayer. 3/24/39 copy served.

June 30—Motion for leave to file brief filed by General Counsel—brief lodged. 7/1/39 granted.

July 15—Reply brief filed by taxpayer. 7/15/39 copy served.

Aug. 25—Memorandum opinion rendered — Charles P. Smith, Division 5. Decision of no deficiency will be entered.

Aug. 25—Decision entered—Charles P. Smith, Division 5.

Nov. 25—Petition for review by U. S. Circuit Court of Appeals, Fifth Circuit, with assignments of error filed by General Counsel.

2 1939
Dec. 4—Proof of Service filed by General Counsel (2).

1940
Jan. 20—Copy of order from U. S. Circuit Court of Appeals, Fifth Circuit, extending the time to March 25, 1940 for preparation of the evidence and transmission of the record, filed.

Mar. 20—Certified copy of order from Fifth Circuit extending the time to April 25, 1940 for preparation of the evidence and transmission of the record, filed.

Apr. 24—Praecipe for record filed by General Counsel—proof of service and agreement thereon.

Apr. 25—Order enlarging time for transmission of record to May 15, 1940, entered.

3 Filed May, 5, 1938

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION
Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent

Docket No. 93321

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated

February 17, 1938 (Symbols IT:C:8-WLM:90D), and as a basis for its proceedings alleges as follows:

1. The petitioner is a corporation with its principal office at Rooms 901 to 913 Slattery Building, Shreveport, Louisiana.

2. The notice of deficiency (a copy of which is attached and marked EXHIBIT I) was mailed to the petitioner on February 17, 1938.

3. The taxes in controversy are income and excess profits taxes for the taxable years ended December 31, 1934 and 1935; and are for the amount of $47,682.41.

4. The determination of the taxes set forth in the said notice of deficiency are based upon the following errors:

4

I

The respondent erred in ruling that the petitioner was not a reorganization but a new corporation, within the purview of section 112 (g) (1) of the Revenue Act of 1934.

II

The respondent erred in finding that the cost of the petitioner of assets acquired from Southwest Gas Utilities Corporation on June 27, 1934 was the sum of $752,000.00; and in not finding that the said cost was the sum of $1,766,694.98.

III

The respondent erred in finding that the basis to the petitioner for determining gain or loss on said assets of Southwest Gas Utilities Corporation was cost to the petitioner; and in not finding that the basis to the petitioner was the substituted basis provided for in section 113 (a)

(7) of the Revenue Act of 1934 of cost to Southwest Gas Utilities Corporation of $8,995,724.91.

IV

The respondent erred in reducing bad debt loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1934 from the sum of $75,090.00 to the sum of $1.26.

V

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1934 the sum of $60,700.69 as alleged gain realized from interest collected.

VI

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1934 the sum of $19,530.10 as alleged gain realized from the collection of advances.

VII

The respondent erred in reducing worthless stock loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1935, from the sum of $3,477,577.00 to the sum of $1.48.

VIII

The respondent erred in adding to the net income of the petitioner for the taxable year ended December 31, 1935 the sum of $25,174.80 as alleged gain realized from collections from affiliates.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

I

ERROR WITH RESPECT TO REORGANIZATION

(a) The Southwest Gas Utilities Corporation, a corporation organized under the laws of the State of Delaware, was placed in receivership in the Court of Chancery for the State of Delaware in and for Newcastle County on December 31, 1933.

(b) The Chancellor of said Court of Chancery signed a decree on May 11, 1934 approving a plan of Reorganization of Southwest Gas Utilities Corporation, said plan having been submitted to the Court on March 16, 1934 by a Reorganization Committee representing
6 all security holders, creditors and stockholders of Southwest Gas Utilities Corporation.

(c) The Plan of Reorganization of Southwest Gas Utilities Corporation, as approved by the Chancellor of said Court, provided for the organization of a new company to acquire the assets of Southwest Gas Utilities Corporation in exchange for shares of common voting stock of the new company and option warrants to purchase additional shares of common voting stock of the new company.

(d) The Chancellor of said Court of Chancery in the said decree of May 11, 1934, assumed jurisdiction for the supervision and carrying out of the Plan of Reorganization, and for the supervision of the issuance of securities proposed to be issued thereunder.

(e) In accordance with the provisions of the Plan of Reorganization, the receivers of Southwest Gas Utilities Corporation held a sale of the properties and assets of Southwest Gas Utilities Corporation, including the equity of redemption in and to all of the securities and cash pledged with and held by the Manufacturers Trust Company, as Trustee under Trust Indenture dated May 1, 1928, securing First Lien and Secured Sinking Fund Gold Bonds,

6½% Series, of Southwest Gas Utilities Corporation; at which sale the Reorganization Committee was the highest bidder. Decree confirming the sale was signed by the Chancellor of the said Court of Chancery on June 20, 1934.

(f) In further pursuance of the Plan of Reorganization, and in accordance with provisions therein, the Manufacturers Trust Company, as Trustee, held a sale of the securities and cash pledged with and held by it under the Trust Indenture dated May 1, 1928; at which sale the Reorganization Committee was likewise the highest bidder. Decree confirming the sale was signed by the Chancellor of the said Court of Chancery on June 27, 1934.

(g) The petitioner was organized on June 27, 1934 by the Reorganization Committee under the laws of the State of Delaware, as the new company provided for in the Plan of Reorganization.

(h) The Reorganization Committee assigned to the petitioner the accepted bids made by it as receivers' and trustee's sales, in consideration of the petitioner assuming all of the liabilities and obligations of the Reorganization Committee under the terms of the bids and the decrees confirming the sales.

(i) The petitioner duly discharged the liabilities and obligations of the Reorganization Committee and consummated the reorganization of Southwest Gas Utilities Corporation by,

(A) issuing 49,010 shares of petitioner's common voting stock for distribution to holders of $2,450,500.00 principal amount of First Lien and Secured Sinking Fund Gold Bonds, 6½% Series, of Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization, and by

(B) depositing with the Manufacturers Trust Company as Trustee, the sum of $95,676.46 for distribution

to holders of $421,000,000 principal amount of said bonds, who had not assented to the Plan of Reorganization, and by

8 (C) issuing 276 shares of petitioner's common voting stock and option warrants to purchase 2760 additional shares of petitioner's common voting stock, for distribution to holders of $138,000.00 principal amount of unsecured claims against Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization, and by

(D) depositing with the receivers of the Southwest Gas Utilities Corporation the sum of $11,007.60 for distribution to holders of $9,000.00 principal amount of unsecured claims against Southwest Gas Utilities Corporation who had not assented to the Plan of Reorganization, and to the holders of $421,000.00 principal amount of said bonds who had not assented to the Plan, and by

(E) issuing option warrants to purchase 17,297 shares of petitioner's common stock to holders of 17,297 shares of preferred stock of Southwest Gas Utilities Corporation, who has assented to the Plan of Reorganization, and by

(F) issuing option warrants to purchase 1,148 7/50 shares of petitioner's common voting stock to holders of 57,470 shares of common stock of Southwest Gas Utilities Corporation, who had assented to the Plan of Reorganization.

(j) The entire assets and properties of Southwest Gas Utilities Corporation as at June 27, 1934 were transferred to petitioner by instruments signed by Southwest Gas Utilities Corporation through its proper office, and by the receivers of Southwest Gas Utilities Corporation, and in the case of pledged assets by Manufacturers Trust Company as Trustee.

9

II

ERROR WITH RESPECT TO COST OF ASSETS OF SOUTHWEST GAS UTILITIES CORPORATION

(a) The petitioner did not purchase the assets of Southwest Gas Utilities Corporation on June 27, 1934 for a cash consideration of $752,000.00, but acquired these assets in exchange for the petitioner's common voting stock and option warrants to purchase common voting stock of petitioner.

(b) Cost to Southwest Gas Utilities Corporation of assets transferred to petitioner as at June 27, 1934 was the sum of $8,995,724.91.

(c) The fair market value of said assets on June 27, 1934, date of acquisition by petitioner, was the sum of $1,766,694.98.

III

ERROR WITH RESPECT TO PETITIONER'S BASIS FOR DETERMINATION OF GAIN OR LOSS

(a) Immediately after the transfer of the assets of Southwest Gas Utilities Corporation to the petitioner, former security holders and stockholders of Southwest Gas Utilities Corporation owned more than 80 percentum of the common voting stock of petitioner, and more than 80 percentum of option warrants for the purchase of common voting stock of the petitioner.

(b) Immediately after the transfer of said assets to petitioner, it had outstanding no securities or stock other than common voting stock and option warrants to purchase common voting stock.

10

IV

ERROR WITH RESPECT TO BAD DEBT LOSS

(a) Principal amount of debts due to the petitioner and charged off during the taxable year ended December 31, 1934, and claimed by the petitioner as a bad debt loss in its income tax return for the same period was the sum of $75,090.00.

(b) Cost of the said debts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to the petitioner was the sum of $75,090.00.

V

ERROR WITH RESPECT TO GAIN REALIZED FROM INTEREST COLLECTED

(a) Total amount of interest collected by petitioner during the taxable year ended December 31, 1934 from interest receivable accounts acquired from Southwest Gas Utilities Corporation on June 27, 1934, was the sum of $104,896.46.

(b) Cost of the said interest receivable accounts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to the petitioner was the sum of $104,896.46.

VI

ERROR WITH RESPECT TO GAIN REALIZED FROM COLLECTION OF ADVANCES

(a) Total amunt of advances collected by petitioner during the taxable year ended December 31, 1934 from accounts of subsidiaries acquired from Southwest Gas Utilities Corporation as at June 27, 1934, was the sum of $33,749.75.

11 (b) Cost of said subsidiaries accounts to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $33,749.75.

VII

ERROR WITH RESPECT TO WORTHLESS STOCK LOSS

(a) Loss claimed by the petitioner in its income tax return for the taxable year ended December 31, 1935, for worthless stocks acquired from Southwest Gas Utilities Corporation as at June 27, 1934, was the sum of $3,477,577.00.

(b) Cost of said stock to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $3,477,577.00.

VIII

ERROR WITH RESPECT TO GAIN REALIZED FROM COLLECTIONS FROM AFFILIATES

(a) Total amount collected by petitioner during the taxable year ended December 31, 1935, from accounts of affiliates acquired from Southwest Gas Utilities Corporation as at June 27, 1934 was the sum of $43,540.28.

(b) Cost of said accounts of affiliates to Southwest Gas Utilities Corporation and basis for determination of gain or loss to petitioner was the sum of $43,540.28.

WHEREFORE the petitioner prays that this Board may hear the proceedings and determine:

(A) That the petitioner acquired the assets and properties of Southwest Gas Utilities Corporation on
12 June 27, 1934 in a "reorganization" within the purview of Section 112 (g) (1) of the Revenue Act of 1934, and

(B) that the basis for determination of gain or loss to the petitioner on said assets and properties of Southwest Gas Utilities Corporation is the same as it would be in the hands of Southwest Gas Utilities Corporation, as provided for in Section 113 (a) (7) of the Revenue act of 1934, and

(C) that the said basis to Southwest Gas Utilities Corporation was cost to Southwest Gas Utilities Corporation in the sum of $8,995,724.91, and

(D) that there is no deficiency due from the petitioner for the taxable year ended December 31, 1934, nor for the taxable year ended December 31, 1935, or in the alternative,

(E) if this Board determines that the basis for determination of gain or loss to the petitioner on assets of Southwest Gas Utilities Corporation acquired on June 27, 1934, is not the said substituted basis, but is cost to petitioner; that the cost to the petitioner was the sum of $1,766,694.98; and that the deficiency, if any, due by the petitioner for the taxable year ended December 31, 1934, and for the taxable year ended December 31, 1935, be computed upon and from the application of said cost of $1,766,694.98.

YANDELL BOATNER,
Counsel for Petitioner
Yandell Boatner
Ricou Brewster Building
Shreveport, Louisiana.

13 State of Louisiana)
Parish of Caddo)

George Belchic, being duly sworn, says that he is the Vice President of Southwest Consolidated Gas Utilities Corporation, the petitioner above named; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements

contained therein, and that the facts stated are true, except those stated to be upon information and belief, and that these he believes to be true.

GEORGE BELCHIC

Subscribed to and sworn before me this the 30th day of April, 1938.

FRED SIMON,
Notary Public

(SEAL)

14 "EXHIBIT I"

TREASUY DEPARTMENT

WASHINGTON

Office of
COMMISSIONER OF INTERNAL REVENUE

February 17, 1938

Southwest Consolidated Gas Utilities Corporation,
901-913 Slattery Building,
Shreveport, Louisiana.

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1934 and 1935 discloses a deficiency of $39,614.75 and that the determination of your excess-profits tax liability for the year(s) mentioned discloses a deficiency of $8,067.66 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiencies mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may

file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies above stated.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
Guy T. Helvering,
Commissioner.
By: Chas. T. Russell
Deputy Commissioner.

Enclosures:
Statement
Form 870
Exhibit A

16 STATEMENT

IT:C:8
WLM:90D

Southwest Consolidated Gas Utilities Corporation,
901-913 Slattery Building,
Shreveport, Louisiana.

Tax Liability for Taxable Years Ended December 31, 1934 and 1935.

Income Tax Liability

Year	Liability	Assessed	Deficiency
1934	$14,991.68	None	$14,991.68
1935	24,623.07	None	24,623.07
Totals	$39,614.75		$39,614.75

Excess-Profits Tax Liability

1934	$3,545.27	None	$3,545.27
1935	4,522.39	None	4,522.39
Totals	$8,067.66		$8,067.66

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the internal revenue agent's reports dated August 22, 1936, and February 23, 1937; to your protests dated October 28, 1936, June 30, 1937, and supplemental data submitted; and to the statements made at the conferences held in New Orleans, Louisiana on January 25, 1937 and the one held in Washington, D. C., on July 2, 1937.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop
17 the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form 870, inserting therein the amount of the deficiency you desire to have as-

sessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

Taxable Year Ended December 31, 1934

Adjustments to Net Income

Net loss as disclosed by return, period June 27, 1934 to December 31, 1934	($ 48,307.10)
As corrected (net income)	109,030.43
Total adjustment as computed below	$157,337.53

Unallowable deductions and additional income:

(a) Capital net gain restored	$ 20.00	
(b) Capital net loss disallowed	2,000.00	
(c) Bad debts disallowed	75,086.74	
(d) Gain realized from interest collected	60,700.69	
(e) Gain realized from collection of advances	19,530.10	
Total		$157,337.53

18 Explanation of Adjustments

(a) Capital net gain restored $20.00.

The capital net gain is computed as follows:

Southwest Gas Companies bonds:

Selling price	$897.50
Cost	877.50
Gain	$ 20.00

This adjustment is made to the income shown on the return because it was included in the capital gain or loss scheduled on the return, which showed a loss of $981,916.18. This loss was limited to $2,000.00 on the return.

(b) Capital net loss disallowed $2,000.00:

This item is restored to the net income inasmuch as this office has ruled that your corporation was not a reorganization but a new corporation, within the purview of section 112(g)(1) of the Revenue Act of 1934.

(c) Bad debts disallowed $75,086.74:

Certain accounts purchased at the foreclosure sale of the assets of Southwest Gas Utilities Corporation were found to be worthless and charged off in 1934 through appraisal, as follows:

Edmond Seymour and Company	$ 6,885.00
Southwest Gas Company (Delaware)	53,505.00
Peoples Gas and Fuel Company	14,700.00
Total	$75,090.00

19 The cost thereof as shown in exhibit A:

Edmond Seymour and Company	$ .42	
Southwest Gas Company (Delaware)	.42	
Peoples Gas and Field Company	.42	1.26
Bad debts allowed		$75,088.74

Only the cost of the assets can be allowed as a deduction.

(d) Gain realized from interest collected $60,700.69:

Of the assets purchased by you at the foreclosure sale of the Southwest Gas Utilities Corporation there were the following interest receivable accounts which were collected subsequent to purchase but prior to December 31, 1934:

Southwest Gas Company (Delaware)		$ .54.16
Northwest Louisiana Gas Company		590.42
Peoples Gas and Fuel Company		739.38
Southwest Gas Utilities Corporation of Oklahoma		103,512.50
Total collections		$104,896.46

The cost of said accounts as shown in exhibit A:

Southwest Gas Company (Delaware)	$ 22.82	
Peoples Gas and Fuel Company	311.69	
Northwest Louisiana Gas Company	248.76	
Southwest Gas Utilities Corporation of Oklahoma	43,612.50	44,195.77
Gain realized		$ 60,700.69

20 (e) Gain realized from collection of advances $19,530.10:

Certain advances made by the Southwest Gas Utilities Corporation to its subsidiaries were purchased by you at foreclosure sale. The following amounts were collected by you subsequent to such foreclosure but prior to December 31, 1934.

Southwest Gas Company (Delaware)	$ 1,431.61
Southwest Gas Utilities Corporation of Oklahoma	765.12
Northwest Louisiana Gas Company (Accrued Interest)	31,553.02
Total collections	$ 33,749.75

The cost of said accounts as shown in exhibit A:

Southwest Gas Company (Delaware)	$ 603.18	
Southwest Gas Utilities Corporation of Oklahoma	322.37	
Northwest Louisiana Gas Company	13,294.10	14,219.65
Net gain realized		$ 19,530.10

Computation of Tax

Income Tax

Net income for taxable year	$109,030.43
Income tax at 13¾ %	$ 14,991.68
Total previously assessed No. 854725	None
Additional income tax to be assessed	$ 14,991.68

21 Capital stock value declared on capital stock returns for excess-profits tax purposes	$609,000.00
Exemption claimed for excess-profits tax purposes	$ 75,000.00

Excess-Profits Tax

Net income	$109,030.43
Excess-profits credit 6/120 of $75,000.00	38,125.00
Net income subject to excess-profits tax at 5%	$ 70,905.43
Excess-profits tax	$ 3,545.27
Previously assessed No. 854725	None
Additional excess-profits tax to be assessed	$ 3,545.27

Taxable Year Ended December 31, 1935

Adjustments to Net Income

Net loss as disclosed by return		($3,392,737.55)
As corrected (net income)		179,076.90
Net adjustment as computed below		$3,571,814.45
Unallowable deductions and additional income:		
(a) Worthless stocks disallowed	$3,477,577.00	
(b) Capital net gain restored	67,064.13	
(c) Capital net loss disallowed	2,000.00	
(d) Gain from collections from affiliates	25,174.80	
Total		$3,571,815.93
Additional deduction:		
(e) Loss on worthless stocks		1.48
Net adjustment as above		$3,571,815.45

22 Explanation of Adjustments

(a) Worthless stocks disallowed $3,477,577.00:

The Southwest Gas Company of Oklahoma and the Southwest Gas Company of Delaware were carried through bankruptcy under section 77-B of the National Bankruptcy Act in 1935.

The losses on stock claimed in the return based on the book value of the preferred and common stocks of the above-named corporation have been disallowed as a deduc-

tion, and in lieu of the loss deducted on the return the cost of the stocks has been allowed as a deduction.

The losses claimed consist of the following:

Name of Company	Preferred Stock	Common Stock	Total
Southwest Gas Company (Delaware)	$284,378.00	$2,093,199.00	$2,377,577.00
Southwest Gas Company of (Oklahoma)	500,000.00	600,000.00	1,100,000.00
Total	$784,378.00	$2,693,199.00	$3,477,577.00

The cost of said stocks as shown in exhibit A is as follows:

Name of Company	Preferred Stock	Common Stock	Total
Southwest Gas Company (Delaware)	$ .42	$ .22	$ .64
Southwest Gas Company of (Oklahoma)	.42	.42	.84
Total	$ .84	$ .64	$ 1.48

23 (b) Capital net gain restored $67,064.13:

This item is restored to the net income inasmuch as this office has ruled that your corporation was not a reorganization, but a new corporation within the purview of section 112(g)(1) of the Revenue Act of 1934. Therefore since the total loss in schedule B has been disallowed the gain as shown below should be restored to income:

	Cost	Selling Price	Gain
First Mortgage Bonds	$127,199.75	$193,063.88	$65,864.13
Preferred stock	390.00	1,590.00	1,200.00
Total			$67,064.13

(c) Capital net loss disallowed $2,000.00:

This item, which was taken as a deduction on the return, is restored to the net income as no loss was sustained on the sale of the assets received from the Southwest Gas Utilities Corporation, as this office has ruled that there was no reorganization of that company within the purview of Section 112(g)(1) of the Revenue Act of 1934.

(d) Gain from collections from affiliates $25,174.80:

The amounts collected in 1935 on the accounts purchased at the foreclosure sale of the assets of the Southwest Gas Utilities Corporation are as follows:

Peoples Gas and Fuel Company Part	$ 7,200.00
Northwest Louisiana Gas Company Part	36,304.28
Total collected	$43,504.28
The cost of the accounts so collected is 42.132% of collections or	18,329.48
Net gain realized	$25,174.80

24 The difference between the allocated cost of the accounts and the amount collected thereon during the year is added to the income in accordance with the ruling of this office that the assets of the Southwest Gas Utilities Corporation was acquired by purchase and not as the result of a nontaxable reorganization.

(e) Loss on worthless stock $1.48:

This represents the cost of the stock which is allowed as a deduction in 1935, because it becomes worthless and was

written off as a loss. The allocated cost of the stock is shown in item (a).

Computation of Tax

Income Tax

Net income for taxable year	$179,067.90
Income tax at 13¾%	$ 24,623.07
Total previously assessed No. 851187	None
Additional income tax to be assessed	$ 24,623.07
Capital stock value declared on capital stock tax returns for excess-profits tax purposes	$709,033.43
Exemption claimed for excess-profits tax purposes	$ 88,629.18

Excess-Profits Tax

Net income	$179,076.90
Excess-profits tax exemption	88,629.18
Net income subject to excess-profits tax	$ 90,447.72
Excess-profits tax at 5%	$ 4,522.39
Previous assessment No. 851187	None
Additional excess-profits tax to be assessed	$ 4,522.39

25 A copy of this letter and statement has been mailed to your representative Mr. A, L. Tillotson, Slattery Building, Shreveport, Louisiana, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Southwest Consolidated Gas Utilities Corporation.

Open Balance Sheet and Adjustments

	Books S.W. G. U. Corp. June 27, 1934	Adjustments Debit	Adjustments Credit	Books SW. C. G. U. Corp. June 27, 1934
Cash:				
Cash Richards and Laskey Revrs.	$ 3,281.34	$	$	$ 3,281.34
Cash Manufacturers Trust Co. Trustee	5,849.19			5,849.18
Cash Matured Coupons	4,078.75			4,078.75
Total Cash	$ 13,209.27			$ 13,209.27
Edmond Seymour and Co.	$ 6,885.00			$ 6,885.00
Receivables:				
Open Accounts:				
Southwest Gas Utilities Service Co.	$ 90,891.39			$ 90,891.39
Southwest Gas Co. (Delaware)	1,431.61			1,431.61
Southwest Gas Co. (Oklahoma)	765.12			765.12
Peoples Gas and Fuel Company	16,778.22			16,778.22
Total open accounts	$ 109,866.34			$ 109,866.34
Interest Receivable:				
1st Mortgage Bonds:				
Southwest Gas Co. (Delaware)	$ 54.16			$ 54.16
Northwest Louisiana Gas	590.42			590.42
Peoples Gas and Fuel Co.	739.38			739.38
Southwest Gas Utilities Corp. of Oklahoma	103,512.50			103,512.50
Southwest Gas Utilities Corp. of Texas	26,054.17			26,054.17
Gen. Mortgage Bonds:				
Southwest Gas Co. Delaware	53,505.00			53,505.00
Peoples Gas and Fuel Co.	14,700.00			14,700.00
1st Mortgage Notes	13,162.50			13,162.50
Total Interest Receivable:	$ 212,318.13			$ 212,318.13
Accrued Interest:				
Southwest Gas Utilities Service Co.	$ 5,950.00			$ 5,950.00
Northwest Louisiana Gas Co.	147,014.43			147,014.43
Peoples Gas and Fuel Co.	44,381.87			44,381.87
Composs Gas Co.	11,212.50			11,212.50

Open Balance Sheet and Adjustments

EXHIBIT A

	Books S.W. G. U. Corp. June 27, 1934	Adjustments Debit	Adjustments Credit	Books SW. C. G. U. Corp. June 27, 1934	Adjustments Debit	Adjustments Credit	Appraised Value June 27, 1934	Adjustments Debit	Adjustments Credit	Cost Basis June 27, 1934
	$ 3,281.34	$	$	$ 3,281.34	$	$	$ 3,281.34	$	$	$ 3,281.34
	5,849.19			5,849.18			5,849.18			5,849.18
	4,078.75			4,078.75			4,078.75			4,078.75
	$ 13,209.27			$ 13,209.27			$ 13,209.27			$ 13,209.27
	$ 6,885.00			$ 6,885.00		$ 6,884.00	$ 1.00		$ .58	$ .42
							$ 1.00			
	$ 90,891.39			$ 90,891.39			90,891.39			$ 38,295.91
	1,431.61			1,431.61			1,431.61			603.18
	765.12			765.12			765.12			322.37
	16,778.22			16,778.22			16,778.22			7,069.10
	$ 109,866.34			$ 109,866.34			$ 109,867.34		$ 63,575.78	$ 48,290.56
	$ 54.16			$ 54.16			$ 54.16			$ 22.82
	590.42			590.42			590.42			248.76
	739.38			739.38			739.38			311.69
	103,512.50			103,512.50			103,512.50			43,612.50
	26,054.17			26,054.17			26,054.17			10,977.30
	53,505.00			53,505.00		$ 53,504.00	1.00			.42
	14,700.00			14,700.00		14,699.00	1.00			.42
	13,162.50			13,162.50			13,162.50			5,545.70
	$ 212,318.13			$ 212,318.13		$ 68,203.00	$ 144,115.13		$ 83,395.52	$ 60,719.61
	$ 5,950.00			$ 5,950.00			$ 5,950.00			$ 2,506.89
	147,014.43			147,014.43			147,014.43			61,941.44
	44,381.87			44,381.87			44,381.87			18,699.24
	11,212.50			11,212.50		$ 11,212.50				
	$ 208,558.80			$ 208,558.80		$ 11,212.50	$ 197,346.30			$ 83,147.57
	537,628.27			$ 537,628.27		$ 86,299.50	$ 451,328.77		$ 261.170.61	$ 190,158.16

Total open accounts				
Interest Receivable:				
1st Mortgage Bonds:				
Southwest Gas Co. (Delaware)		$ 54.16		$ 54.16
Northwest Louisiana Gas		590.42		590.42
Peoples Gas and Fuel Co.		739.38		739.38
Southwest Gas Utilities Corp. of Oklahoma		103,512.50		103,512.50
Southwest Gas Utilities Corp. of Texas		26,054.17		26,054.17
Gen. Mortgage Bonds:				
Southwest Gas Co. Delaware		53,505.00		53,505.00
Peoples Gas and Fuel Co.		14,700.00		14,700.00
1st Mortgage Notes		13,162.50		13,162.50
Total Interest Receivable:		$ 212,318.13		$ 212,318.13
Accrued Interest:				
Southwest Gas Utilities Service Co.		$ 5,950.00		$ 5,950.00
Northwest Louisiana Gas Co.		147,014.43		147,014.43
Peoples Gas and Fuel Co.		44,381.87		44,381.87
Composs Gas Co.		11,212.50		11,212.50
Total Accrued Interest		$ 208,558.80		$ 208,558.80
Total Receivables		537,628.27		$ 537,628.27
Investments:				
Preferred Stock:				
Southwest Gas Co. (Delaware)	2,850 shares	$ 284,378.00		$ 284,378.00
Southwest Gas Co. of Oklahoma	5,000 shares	500,000.00		500,000.00
Northwest Louisiana Gas Co.	50 shares	2,125.00		2,125.00
Southwest Utilities Service Co.	4,151 shares	415,100.00		415,100.00
Total Preferred Stock		$1,201,603.00		$1,201,603.00
Common Stock:				
Southwest Gas Co. (Delaware)	175,000 shares	$2,093,199.00		$2,093,199.00
Southwest Gas Co. of Oklahoma	20,000 shares	600,000.00		600,000.00
Northwest Louisiana Gas Co.	59,238 shares	889,920.00		889,920.00
Composs Gas Co.	2,000 shares	212,271.08		212,271.08
Southwest Gas Utilities Service Co.	1,000 shares	626,541.00		626,541.00
Southwest Gas Utilities Corp. Oklahoma	2,000 shares	2,000.00		2,000.00
Southwest Gas Utilities Corp. of Texas	10 shares	77,863.54		77,863.54 $
Total Common Stock		$4,501,794.62		$4,501,794.62 $

		$ 54.16			$ 54.16			$ 54.16			$ 22.82
		590.42			590.42			590.42			248.76
		739.38			739.38			739.38			311.69
		103,512.50			103,512.50			103,512.50			43,612.50
		26,054.17			26,054.17			26,054.17			10,977.30
		53,505.00			53,505.00		$ 53,504.00	1.00			.42
		14,700.00			14,700.00		14,699.00	1.00			.42
		13,162.50			13,162.50			13,162.50			5,545.70
		$ 212,318.13			$ 212,318.13		$ 68,203.00	$ 144,115.13		$ 83,395.52	$ 60,719.61
		$ 5,950.00			$ 5,950.00			$ 5,950.00			$ 2,506.89
		147,014.43			147,014.43			147,014.43			61,941.44
		44,381.87			44,381.87			44,381.87			18,699.24
		11,212.50			11,212.50		$ 11,212.50				
		$ 208,558.80			$ 208,558.80		$ 11,212.50	$ 197,346.30			$ 83,147.57
		537,628.27			$ 537,628.27		$ 86,299.50	$ 451,328.77		$ 261,170.61	$ 190,158.16
2,850	shares	$ 284,378.00			$ 284,378.00		$ 284,377.00	$ 1.00			$ .42
5,000	shares	500,000.00			500,000.00		499,999.00	1.00			.42
50	shares	2,125.00			2,125.00		2,124.00	1.00			.42
4,151	shares	415,100.00			415,100.00			415,100.00			174,892.42
		$1,201,603.00			$1,201,603.00		$ 786,500.00	$ 415,103.00		$ 240,209.32	$ 174,893.68
175,000	shares	$2,093,199.00			$2,093,199.00		$2,093,198.50	$ .50			$ .22
20,000	shares	600,000.00			600,000.00		599,999.00	1.00			.42
59,238	shares	889,920.00			889,920.00		889,919.50	.50			.22
2,000	shares	212,271.08			212,271.08		212,271.08	-0-			
1,600	shares	626,541.00			626,541.00		533,482.39	93,058.61			39,208.01
2,000	shares	2,000.00			2,000.00			2,000.00			842.65
10	shares	77,863.54			77,863.54	$ 113,169.79		191,033.33			80,487.31
		$4,501,794.62			$4,501,794.62	$ 113,169.79	$4,328,870.47	$ 286,093.94		$ 165,555.11	$ 120,538.83

Open Balance Sheet and Adjustments

Southwest Consolidated Gas Utilities Corporation.

Assets	Books SW. G. U. Corp. June 27, 1934	Adjustments Debit	Adjustments Credit	Books SW. C. G. U. Corp June 27. 1934
1st Mortgage Bonds:				
Southwest Gas Co. (Delaware)	$ 3,200.00	$	$	$ 3,200.00
Northwest Louisiana Gas Co.	109,000.00			109,000.00
Peoples Gas and Fuel Co.	45,500.00			45,500.00
Southwest Gas Utilities Corp. of Oklahoma	735,000.00			735,000.00
Southwest Gas Utilities Corp. of Texas	185,000.00			185,000.00
Total 1st Mortgage Bonds	$1,077,700.00			$1,077,700.00
General Mortgage Bonds:				
Southwest Gas Co. (Delaware)	$ 344,400.00			$ 344,400.00
Peoples Gas and Fuel Co.	85,450.00			85.450.00
Total General Mortgage Bonds	$ 429,850.00			$ 429,850.00
1st Mortgage Notes:				
Peoples Gas and Fuel Co.	$ 90,000.00			$ 90,000.00
Total Investments	$7,300,947.62			$7.300,947.62
Unsecured Notes:				
Southwest Gas Utilities Service Co.	$ 30,000.00			$ 30,000.00
Composs Gas Co.	338,141.00			338,141.00
Northwest Louisiana Gas Co.	576,341.25			576,341.25
Peoples Gas and Fuel Co.	199,457.50			199,457.50
Total Unsecured Notes	$1,143,939.75			$1,143,939.75
Total Assets	$8,995,724.91			$8,995,724.91
Liabilities:				
Accounts Payable	$ 31,945.42	$ 31,945.42	$ 108.197.92	$ 108,197.92
Accrued Interest Bonds	425,608.14	425,608.14		
Accrued Interest Notes	13,740.30	13,740.30		
Five Year Notes Payable	126,000.00	126,000.00		
Bonds Payable	2,871,500.00	2,871,500.00		
Capital:				
Preferred Stock	2,684,376.50	2,684,376.50		
Common Stock	2,801,509.00	2,801,509.00	49,168.00	49,168.00
Surplus	41,045.55	41,045.55		
Reorganization Surplus		157,265.02	8,995,724.91	8,838.358.99
Total Liabilities	$8,995,724.91			$8,995,724.91

Open Balance Sheet and Adjustments

EXHIBIT A

	Books SW. G. U. Corp. June 27, 1934	Adjustments Debit	Adjustments Credit	Books SW. C. G. U. Corp June 27, 1934	Adjustments Debit	Adjustments Credit	Appraised Value June 27, 1934	Adjustments Debit	Adjustments Credit	Cost Basis June 27, 1934
	$ 3,200.00	$	$	$ 3,200.00	$	$ 1,450.00	$ 1,450.00	$	$	$ 737.32
	109,000.00			109,000.00		76.300.00	32,700.00			13,777.36
	45,500.00			45,500.00		31,395.00	14,105.00			5.942.80
	735,000.00			735,000.00		487,600.00	247,400.00			104,236.05
	185,000.00			185,000.00			185,000.00			77,945.31
	$1,077,700.00			$1,077,700.00		$ 596,745.00	$ 480,955.00		$ 278,316.16	$ 202,683.84
	$ 344,400.00			$ 344,400.00		$ 344,399.00	$ 1.00			$ .42
	85,450.00			85.450.00		85,449.00	1.00			.42
	$ 429,850.00			$ 429,850.00		$ 429.848.00	$ 2.00		$ 1.16	$ .84
	$ 90,000.00			$ 90,000.00			$ 90,000.00		$ 52,080.66	$ 37,919.34
	$7,300,947.62			$7.300,947.62	$ 113,169.79	$6,141,963.47	$1,272,153.94		$ 736,162.41	$ 535,991.53
	$ 30,000.00			$ 30,000.00			$ 30,000.00			$ 12,639.78
	338,141.00			338,141.00		$ 338,140.00	1.00			.42
	576,341.25			576,341.25		576,340.25	1.00			.42
	199,457.50			199,457.50		199.456.50	1.00			.42
	$1,143,939.75			$1,143,939.75		$1,113,936.75	$ 30,003.00		$ 17,361.96	$ 12,641.04
	$8,995,724.91			$8,995,724.91	$ 113,169.79	$7,342,199.72	$1,766,694.98		$1,014,694.98	$ 752,000.00
	$ 31,945.42	$ 31,945.42	$ 108,197.92	$ 108,197.92	$	$	$ 108,197.92	$	$	$ 108,197.92
	425,608.14	425,608.14								
	13,740.30	13,740.30								
	126,000.00	126,000.00								
	2,871,500.00	2,871,500.00								
	2,684,376.50	2,684,376.50								
	2,801,509.00	2,801,509.00	49,168.00	49,168.00			49,168.00			49,168.00
	41,045.55	41,045.55								
		157,265.02	8,995,724.91	8,838,358.99	7,542,199.72	113,169.79	1,609,329.06	1,014,694.98		594,634.08
	$8,995,724.91			$8,995,724.91			$1,766,694.98			$ 752,000.00

28 United States Board of Tax Appeals
Filed June 23, 1938.

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321.

ANSWER

COMES NOW the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for his answer to the petition herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that he erred in his determination of the deficiencies as shown by the deficiency notice from which the taxpayer's appeal was taken. Specifically denies that he erred in the manner and form as alleged in subdivisions (I) to (VIII), inclusive, of paragraph 4 of the petition.

5. Denies the allegations contained in subdivision (a) to (j), inclusive, of subparagraph (I) of paragraph 5 of the petition. Denies the allegations contained in sub-

division (a), (b) and (c) of paragraph II of paragraph 5 of the petition. Denies the allegations
29 contained in subdivision (a) and (b) of subparagraph (III) of paragraph 5 of the petition. Denies the allegations contained in subdivisions (a) and (b) of subparagraph (IV) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (V) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VI) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VII) of paragraph 5 of the petition. Denies the allegations contained in subdivision (a) and (b) of subparagraph (VIII) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied and the taxes as shown in the deficiency notice be in all respects approved.

(Signed) J. P. WENCHEL,
GWK
Chief Counsel,
Bureau of Internal Revenue.

OF COUNSEL

JOHN H. PIGG,
Special Attorney,
Bureau of Internal Revenue.

JHP/lmv 6/22/38

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Filed March 13, 1939.
U. S. Board of Tax Appeals

UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION,
Petitioner,

-against-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321.

MOTION

The name of petitioner has been changed from Southwest Consolidated Gas Utilities Corporation to Southwest Consolidated Corporation, pursuant to action of the stockholders taken at a special meeting held January 6, 1939 and Certificate of Change of Name filed with the Secretary of State of the State of Delaware on January 12, 1939, certified copy of which was thereafter filed with the Recorder of Deeds for the County of New Castle, State of Delaware.

It is therefore moved that the style of this proceeding be changed accordingly and the petitioner hereafter be referred to in this proceeding as Southwest Consolidated Corporation.

(s) A. C. NEWLIN
Counsel for Petitioner

Dated: March 13, 1939.

NO OBJECTION
(s) J. P. Wenchel
Chief Counsel,
Bureau of Internal Revenue.

31 UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED GAS UTILITIES CORPORATION, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 93321.

ORDER CHANGING TITLE OF PROCEEDING.

On motion of the petitioner to change the title of the proceeding filed in the above-entitled case on March 13, 1939, to which counsel for the respondent interposes no objection, it is—

ORDERED that the title of this proceeding be and the same is hereby changed to read "Southwest Consolidated Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent."

(s) J. RUSSELL LEECH
Member.

JRL:aa.

Dated: March 15, 1939.

(SEAL)

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UNITED STATES BOARD OF TAX APPEALS

SOUTHWEST CONSOLIDATED CORPORATION, PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 93321.√

Fred Simon, esq. and A. Chauncey Newlin, Esq., for the petitioner.

Joe D. Hughes, Esq., for the respondent.

MEMORANDUM OPINION.

SMITH: This proceeding involves income and excess-profits taxes for the year 1934 and 1935 as follows:

	Income Tax	Excess-Profits Tax
1934	$14,991.68	$3,545.27
1935	24,623.07	4,522.39

The question in issue in both years is the cost basis to the petitioner of certain assets formerly owned by a predecessor corporation which it acquired in exchange for its own stock and securities.

Petitioner is a Delaware corporation organized June 27, 1934, and is the successor of Southwest Gas Utilities Corporation whose assets it acquired under foreclosure sale soon after its organization.

Southwest Gas Utilities Corporation, hereinafter referred to as the Utilities Company, was a public utilities corporation organized under the laws of the State of Delaware on April 10, 1928.

33 On May 1, 1932, the Utilities Company defaulted in the payment of its interest on certain of its outstanding bonds, being a series of 6½% First Lien and Secured Sinking Fund Gold Bonds in the face amount of $2,871,500, which were issued under authorization of an indenture dated May 1, 1928, between the Utilities Company and Chatham Phenix National Bank & Trust Co. as trustee. Under this indenture the Utilities Company pledged certain of its assets including shares of stock and bonds of its subsidiary companies with the trustee as security for the bond issue. On May 19, 1932, the pledged securities were transferred to the Manufacturers Trust Co., successor trustee to the Chatham Phenix National Bank & Trust Co.

On May 2, 1932, a bondholders' committee was organized to protect the interests of the bondholders. Members of the committee later became directors of the Utilities Company and, after October 7, 1932, were in control of it. About 85 percent of the outstanding bonds were deposited with the committee.

On April 10, 1933, a bill in equity was filed in the Court of Chancery of the State of Delaware, New Castle County, by one of the bondholders alleging insolvency of the Utilities Company and praying for the appointment of a receiver. The Utilities Company admitted insolvency, in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Charles F. Richards of Wilmington, Delaware, and Charles G. Laskey of Shreveport, Louisiana, president of the Utilities Company, were appointed receivers.

34 On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization" for the Utilities Company. It is not necessary for the purpose of our decision to give a full disclosure of the details of the reorganization plan. It provided in brief that a new company should be organized (the petitioner herein) which would acquire by direct purchase or under foreclosure proceedings the collateral assets held by the Manufacturers Trust Co. and also any "free assets" of the Utilities Company which the committee might consider of value to the new company. The capital structure of the new company was as follows:

Description	Amount Authorized	Amount Issued
Common stock, $1 par value	200,000 shares	57,718 shares
Class A Option Warrants	2,880 warrants	2,880 warrants
Class B Option Warrants	50,000 warrants	34,682-3/10 warrants

The common stock had a par value of $1 per share or "such different par value" as the committee might think best. The Class A option warrants carried the right to buy one share of common stock at $6 a share during 1934 and at an increase of $1 per share for each year thereafter up to and including 1938. Similarly, the Class B option warrants carried the right to buy one share of common stock at $10 a share during 1934 and at an increased price of $5 per share for each succeeding year up to and including 1938.

The plan of reorganization provided for the diposition of securities of the new company as follows:

> The holders of the outstanding First Lien and Secured sinking fund Gold Bonds 6½% Series, due 1943, of the Company, who participate in the plan will receive new securities on the basis of twenty shares of common stock in the New Company for each $1000 principal amount held.

35 The holders of Five Year 6% Convertible Gold Notes due October 1, 1934, of the Company will receive two shares of common stock of the New Company and twenty Class A warrants of the New Company for each $1000 principal amount held.

Holders of unsecured claims against the Company, which may be proved and allowed in the receivership proceedings, will be afforded equal treatment with the holders of the Five-Year 6% Convertible Gold Notes of the Company and will receive two shares of Common Stock of the New Company and twenty (20) Class A Warrants of the New Company for each $1,000 principal amount of claim allowed.

The holders of $6.50 Preferred Stock of the Company will receive one Class B Warrant of the New Company for each share held.

The holders of common stock of the Company will receive one Class B Warrant* of the New Company for each fifty shares held.

[* Not material]

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against the Utilities Company and on May 11, 1934, the Chancellor issued a decree approving the reorganization plan.

Pursuant to such plan of reorganization and by order of the Chancery Court the assets pledged as security for the bonds of Utilities Company were sold by the trustee at foreclosure sale on June 25, 1934, and bid in by the bondholders' committee at a price of $660,000. The unpledged assets of the Utilities Company were purchased by the bondholders' committee at public auction on June 18, 1934, for $92,000. The sale of these assets was confirmed by the Chancery Court.

Pursuant to the plan of reorganization, common stock and "A" and "B" warrants of the petitioner were
36 issued and exchanged for bonds, notes, claims and stock of Utilities Company, as follows:

UTILITIES COMPANY			SOUTHWEST CONSOLIDATED		
			Securities Issued in Exchange Pursuant to Plan		
Security	Total Amount	Amount Participating in Plan	Common Stock	A Warrants	B Warrants
Bonds	$2,871,500.00	$2,450,500.00	49,010		
Notes	$ 126,000.00	$ 107,000.00	214	2,140	
Other Unsecured Claims	$ 31,945.42	$ 31,945.42	62	620	
Preferred Stock	32,244 sh.	17,297			17,297
Common Stock	171,915	57,470			1,148 7/50
			49,286	2,760	18,445 7/50

Non-participating security holders of Utilities Company ($421,000 of bonds and $19,000 of notes) received $106,-684.06 in cash. The cash necessary to make this payment and to meet the expenses connected with the sale of the pledged and unpledged assets of Utilities Company was obtained by means of a loan from Manufacturers Trust Co., which loan was assumed by the petitioner and was later repaid by it.

Holders of $871,500 principal amount of bonds and $65,000 principal amount of notes of Utilities Company participating in the plan of reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes these security holders received 17,560 shares of common stock of the petitioner and 1300 Class A warrants. With respect to their holdings of common and preferred stock of Utilities Company these individuals received 3,132 Class B warrants.

37 Giving effect to this situation, the following table shows total distribution of common stock, and warrants to purchase common stock, of the petitioner to former stockholders of Utilities Company and to non-stockholders:

Class of Security of Southwest Consolidated	Total Issued by Southwest Consolidated	Issued to Stockholders of Utilities Co.	Issued to Nonstockholders of Utilities Co.
Common Stock	49,286	17,560	31,726
Class "A" Warrants	2,760	1,300	1,460
Class "B" Warrants	18,445 7/50	18,445 7/50	
Total	70,491 7/50	37,305 7/50	33,186

Of the 2,760 Class "A" warrants issued, 1,760 were exercised, and of the 18,455-7/50 Class "B" warrants issued, 4,623 were exercised, before they expired in 1938.

The cost to Utilities Company for the assets transferred to the petitioner as of June 27, 1934, was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98. These aggregate figures were divided among the various assets.

Upon petitioner's organization and during 1934 all of the Utilities Company's assets, or the bondholders' rights to such assets, were assigned to it.

The Utilities Company filed a final income and excess-profits tax return for the calendar year 1934 in which it reported a loss of $257,647.93 for the period January 1, 1934, to June 27, 1934.

Petitioner filed an income and excess-profits tax return for the period June 27, 1934, to December 31, 1934, in which it reported a net loss of $48,307.10. In his de-

38 ficiency notice the respondent determined a net income for that period of $109,030.43. The principal adjustments made by the respondent were the disallowance of bad debts in the amount of $75,086.74 and additions to income of $60,700.69 representing "gain realized from interest collected" and $19,530.10 representing "Gain realized from collection of advances." The debts and accounts referred to were among the assets of the Utilities Company which were assigned to the petitioner under the reorganization plan described above. Bad debts were charged off by the petitioner in the total amount of $75,090. Respondent does not question the worthlessness of the debts but contends that the aggregate cost to the petitioner, on the theory that they were not acquired in a statutory reorganization, was only $1.26. Accordingly he has disallowed the balance of the amount which petitioner charged off.

The additions to petitioner's income of interest and advance collected were made on the same theory, that is, that the cost basis of the accounts to the petitioner was not their face value, or their cost to the Utilities Company, but the price which the petitioner paid for them at the foreclosure sale, amounting to $44,195.77 as to the interest accounts, and $14,219.65 as to the advances to subsidiary companies.

Petitioner filed a return for 1935 in which it reported a net loss of $3,392,737.55 while the respondent has determined that petitioner had a net income in that year of $179,076.90. The principal adjustments made by the respondent for that year are as follows:

(a) Worthless stocks disallowed	$3,477,577.00
(b) Capital net gain restored	67,064.13
(c) Capital net loss disallowed	2,000.00
(d) Gain from collections from affiliates	25,174.80
Total	$3,571,815.93

39 The above adjustments result in the main from the respondent's determination that petitioner did not acquire the assets of Utilities Company in a reorganization and that the cost basis of the assets to the petitioner is not the same as it was to the Utilities Company but is the price at which the assets were bid in by the bondholders' committee at the foreclosure sale.

The parties are in agreement that the cost basis to the petitioner of the assets of Utilities Company is the only question in issue in this proceeding. If such cost basis to the petitioner is found to be the same as it was to the Utilities Company petitioner will have no tax liability for either of the taxable years involved.

The pertinent provisions of the statute are found in sections 112 and 113 of the Revenue Act of 1934, which read in part as follows:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in Kind.—

* * * * *

(4) Same—Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to Corporation Controlled by Transferror.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * * *

(g) Definition of Reorganization.—As used in this section and section 113—

(1) The term "reorganization" means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, * * *

* * * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * * * *

(7) Transfers to Corporation Where Control of Property Remains in Same Persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as to the consideration in whole or in part for the transfer.

(8) Property Acquired By Issuance of Stock or as Paid-In Surplus.—If the property was acquired after December 31, 1920, by a corporation—

41 (A) By the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

Then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

By section 112 (g) (1) "The term 'reorganization' means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: * * * of substantially all the properties of another corporation".

In the proceeding at bar the petitioner acquired all of the assets of the Utilities Company in exchange for its shares of stock and warrants. The respondent submits:

* * * While petitioner acquired the remaining assets of the old company, it acquired those assets from the bondholders' committee rather than from the old company and the acquisition by one corporation of the property of another corporation from third parties does not constitute a non-taxable reorganization. * * *

The Board is of the opinion that this contention made by the respondent does not apply to the proceeding at bar.

In Commissioner v. Kitselman (CCA, 7th Cir), 89 Fed. (2d) 458, Art. Trn. 302 U. S. 709, the court held, reversing the Board, that a statutory reorganization occurred where, under facts almost identical with those in the instant case,

the assets of an insolvent corporation which were
42 pledged as security for the corporation's bonds were purchased at foreclosure sale by the bondholders' committee and were assigned to the new corporation in exchange for its stock and securities. The court, in its opinion, said:

> Bondholders are ordinarily viewed merely as creditors, but when the assets of the corporation are less than its obligations, the bondholders are in actuality and for all practical purposes pretty much the corporation. All that remains for the stockholders is the corporate charter—the corpse of the defunct corporation. When the new corporation was formed by the bondholders' representatives, it received all the corporate assets in exchange for the new company's stocks and bonds. The old stockholders as such received nothing.
>
> There may not have been a reorganization in the sense that the capital structure was changed (except as to the bonds), but the essence of the corporate life—all its assets, were transferred by its bondholders to a new corporation in exchange for that corporation's stocks and bonds. It is not indispensable to a reorganization that there be a dissolution of the old corporation.
>
> The novelty of this situation arises from the lack of participation by stockholders of the transferor corporation. If they participated, there would be little doubt as to the existence of a reorganization.
>
> It is clear that the bondholders were the moving spirit and were treated as the owners in fact, and it follows that they must be viewed as a class of "stockholders" somewhat akin to preferred stockholders with cumulative dividend rights. Their position was stepped up by reason of what had occurred and the finding that there was no equity over the lien of the mortgage. Where the assets of the corporation fall far below the amount required to pay the bondholders in full, the bondholders in bankruptcy reorganization supersede the stockholders. They acquire the stockholders' rights to manage the corporate affairs. * * *

43 Also in commissioner v. Newberry Lumber & Chemical Co., 94 Fed. (2d) 447, the Circuit Court of Appeals for the Sixth Circuit reached the same conclusion (reversing 33 B.T.A. 150) on substantially the same facts. The court there said:

> In the case at bar neither the petitioner nor its stockholders received any profit from the reorganization. The predecessor corporation transferred all of its assets to the petitioner, and immediately after, the transferor, through its bondholders, was in control of the assets transferred. It makes no difference that the transaction was effected by the bondholders' committee, for that committee acted for and represented the bondholders in the old corporation, who became bondholders and stockholders in the reorganized corporation. Nor is it important that the committee represented no stockholders in the original corporation, since it did represent the bonds, which are securities as indicated in the Minnesota tea Company and Watt Cases, supra. In our opinion there was a reorganization within the meaning of the statute. Where there is a reorganization there is no taxable gain in the transaction. In such case, too, the statute provides that the capital base for the reorganized corporation is the cost of the assets to the old corporation. Section 113 (a) (7) and section 114 (a) and (b) (1), of the Revenue Act of 1928, 26 U.S.C.A. § § 113, 114 notes. * * *.

In Frederick L. Leckie, 37 B.T.A. 252, the Board followed Commissioner Kitselman, supra, holding, upon facts not materially different from those in the instant case, that a reorganization took place where assets of a corporation in default of its first mortgage bonds were bid in at foreclosure sale by a bondholders' committee and transferred to a new corporation in exchange for its stock which was ultimately distributed to the participating bondholders.

See also Howard Hotel Corporation, 39 B.T.A. 1147.

44 On authority of the cases cited we hold that under the facts set out above there was a statutory reorganization and that the cost basis to the peitioner of the assets acquired by it pursuant to such plan of reorganization is the same as the cost basis of the assets in the hands of the Utilities Company.

Decision of no deficiency will be entered.

Copies served on both Parties

ENTERED AUG 25 1939

(SEAL)

45 UNITED STATES BOARD OF TAX APPEALS

WASHINGTON

SOUTHWEST CONSOLIDATED CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 93321

DECISION

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion, entered August 25, 1939, it is

ORDERED AND DECIDED: That there are no deficiencies in income or excess-profits taxes for the years 1934 and 1935.

(Signed) CHARLES P. SMITH
Member.

Entered Aug 25 1939

(Seal)

46 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Nov 25 1939

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review.	B. T. A. Docket No. 93321

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

NOW COMES the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

JURISDICTION

The petitioner on review is the duly appointed, qualified and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States.

The respondent on review, Southwest Consolidated Corporation (formerly known as Southwest Consolidated Gas Utilities Corporation) hereinafter referred to as the taxpayer, is a corporation organized under the laws of the State of Delaware, with its principal office at Rooms 901-913 Slattery Building, Shreveport, Louisiana. The taxpayer filed its Federal income and excess-profits tax returns for the taxable years of 1934 and 1935 with the Collector of Internal Revenue for the district of Louisiana and within the judicial district of the United States Circuit Court of Appeals for the Fifth Circuit.

47

II.

PRIOR PROCEEDINGS

On February 17, 1938, the Commissioner determined deficiencies in income taxes against the taxpayer for the taxable years ended December 31, 1934 and 1935 in the respective amounts of $14,991.68 and $24,623.07, and deficiencies in excess-profits tax for those years in the respective amounts of $3,545.27 and $4,522.39, and sent by registered mail a notice of said deficiencies in accordance with section 272 of the Revenue Act of 1934. Thereafter and on May 5, 1938, the taxpayer filed a petition for a redetermination of said deficiencies by the United States Board of Tax Appeals.

The case was tried before the Board of Tax Appeals on January 23, 1939 at Shreveport, Louisiana.

On August 25, 1939, the Board entered its memorandum opinion, and on August 25, 1939 entered its decision wherein it was ordered and decided that there are no deficiencies in income or excess-profit taxes for the years 1934 and 1935.

48

III

NATURE OF CONTROVERSY

The question presented was what is the proper cost basis to the taxpayer of certain assets formerly owned

by a predecessor corporation which it acquired in exchange for its own stock and securities.

The taxpayer herein is the successor of the Southwest Gas Utilities Corporation, hereinafter referred to as Utilities Company. On May 1, 1932, the Utilities Company was in default in the payment of interest on its outstanding First Lien and Secured Sinking Fund Gold Bonds with a face value of $2,871,500. A bondholders' committee was organized to protect the interest of the bondholders and the members of the committee became directors of the Utilities Company. A bill in equity was filed by the committee alleging insolvency of the Utilities Company and praying for the appointment of a receiver. The Utilities Company admitted it was insolvent.

Pursuant to a "Plan of Reorganization" adopted by the committee a new corporation (the taxpayer herein) was organized to acquire by purchase under foreclosure proceedings, the assets of the Utilities Company. The new company was authorized to issue 200,000 shares of common stock with a par value of $1 a share and to issue class A and B option warrants in the respective amounts of 2,880 and 50,000. These warrants permitted the holders thereof to purchase common stock of the new company at a specified price within a given time limit.

Pursuant to the plan of reorganization the assets of the Utilities Company were purchased by the bondholders' committee and in turn assigned to the
49 new corporation. The holders of bonds, notes and preferred stock of the Utilities Company exchanged their holdings for stock and Class A and B warrants of the new company. Of the total outstanding bonds of the Utilities Company amounting to $2,871,000, holders of $2,450,500 of said bonds participated in the plan of reorganization. Likewise of the notes outstanding against said Utilities Company of $126,000, the holders of $107,000 worth of the notes participated in the reorganization.

The Commissioner determined that taxpayer did not acquire the assets of Utilities Company in a reorganization and that the cost basis of the assets to the taxpayer was not the same as it was to the Utilities Company, but was the price at which the assets were bid in by the bondholders' committee at the foreclosure sale. The Board held that the transaction in question constituted a statutory reorganization and and that the cost basis to the taxpayer of the assets acquired by it pursuant to such plan of reorganization was the same as the cost basis of the assets in the hands of the Utilities Company.

IV.

ASSIGNMENTS OF ERROR

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals:

50 1. The Board erred in holding and deciding that there are no deficiencies in income or excess-profits taxes for the years 1934 and 1935.

2. The Board erred in failing to hold and decide that there are deficiencies in income taxes for the taxable years 1934 and 1935 in the respective amounts of $14,991.68 and $24,623.07, and deficiencies in excess-profits taxes for those years in the respective amounts of $3,545.27 and $4,522.39.

3. The Board erred in holding and deciding that on authority of the cases cited by it, there was a statutory reorganization and that the cost basis to the taxpayer of the assets acquired by it pursuant to such plan of reor-

ganization is the same as the cost basis of the assets in the hands of the Utilities Company.

4. The Board erred in failing to hold and decide that there was no statutory reorganization and that the cost basis to the taxpayer of the assets acaquired by it from the bondholders' committee was the price at which the assets were bid in by the bondholders' committee at the foreclosure sale.

5. The Board erred in that its decision is not supported by the evidence and is contrary to law.

WHEREFORE, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fifth Circuit, that a transcript of the record be pre-
51 pared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

(Signed) SAMUEL O. CLARK, Jr.,

Assistant Attorney General

(Signed) J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

OF COUNSEL:

JOHN M. MORAWSKI,

Special Attorney,

Bureau of Internal Revenue.

52 UNITED STATES OF AMERICA)
DISTRICT OF COLUMBIA)

JOHN M. MORAWSKI, being duly sworn, says that he is a Special Attorney in the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Signed) JOHN M. MORAWSKI,

Special Attorney,

Bureau of Internal Revenue.

Sworn and subscribed to before me
this 25 day of November, 1939.

(Signed) GEORGE W KILIS

Notary Public.

My commission expires Nov. 15, 1942.

53 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Dec 4 1939

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review.	B. T. A. Docket No. 93321

NOTICE OF FILING PETITION FOR REVIEW

To: Southwest Consolidated Corporation,
901 Slattery Building,
Shreveport, Louisiana.

You are hereby notified that the Commissioner of Internal Revenue did on the 25th day of November, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 27th day of November, 1939.

(Signed) J. P. WENCHEL,
RLW
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 28 day of November, 1939.

SOUTHWEST CONSOLIDATED CORPORATION

By (Signed) GEORGE BELCHIC

Vice President

Respondent on Review.

54 Copy

Shreveport, La.,
Nov. 25, 1939.

Southwest Consolidated Corporation,

901 Slattery Bldg.,

Shreveport, La.,

Sirs:

I am in receipt of instructions from J. P. Wenchel, Chief Counsel, Internal Revenue, Washington, D. C., to serve upon you the following, in the U. S. Circuit Court of Appeals for the 5th Circuit, Guy T. Helvering, Commissioner of Internal Revenue, petitioner, on review versus Southwest Consolidated Corporation, respondent on review BTA No. 93321, notice of filing petition for review to Southwest Consolidated Corporation, 991 Slattery Bldg., Shreveport, La.

You are hereby notified that the Commissioner of Internal Revenue did, on the 25th day of November, 1939,

file with the clerk of the U S Board of Tax Appeals at Washington, D. C., a petition for review by the U S Circuit Court of Appeals for the 5th Circuit of the decision of the Board heretofore rendered in the above entitled case.

Respectfully,

(Signed) A. R. LACEY,

Internal Revenue Agent.

This is to certify the foregoing notice was served upon Mr. George Belchic, Vice-President, Southwest Consolidated Corporation, in person at his residence, 6500 Gilbert Drive, Shreveport, La., 5.15 PM, November 25th, 1939.

(Signed) A. R. LACEY,

Internal Revenue Agent.

55 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Dec 4 1939

GUY T. HELVERING, Commis- Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review.	B. T. A. Docket No. 93321

NOTICE OF FILING PETITION FOR REVIEW

To: Fred Simon,

Attorney for Southwest Consolidated Corporation,

Ricou-Brewster Building,

Shreveport, Louisiana.

You are hereby notified that the Commissioner of Internal Revenue did on the 25th day of November, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 27th day of November, 1939.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 28 day of November, 1939.

(Signed) FRED SIMON

Counsel for Respondent on Review.

56

COPY

Shreveport, La., Nov. 25, 1939

Fred Simon, Attorney,

S. W. Consolidated Corp.,

Ricou-Brewster Bldg.,

Shreveport, La.

Sir:

I am in receipt of instructions from Mr J P Wenchel, Chief Counsel Internal Revenue, Washington, D. C., to serve upon you as attorney for the Southwest Consolidated Corp., Shreveport, La., notice of filing petition for review, in the U. S. Circuit Court of Appeals for the 5th Circuit, Guy T Helvering, Commissioner of Internal Revenue, petitioner on review versus Southwest Consolidated Corporation, respondent on review BTA No. 93321.

You are hereby notified that the Commissioner of Internal Revenue did, on the 25th day of November, 1939 file with the clerk of the U. S. Board of Tax Appeals at Washington, D. C., a petition for review by the U. S. Circuit Court of Appeals for the 5th Circuit of the decision of the Board heretofore rendered in the above entitled case.

Respectfully,

(signed) A. R. LACEY

Internal Revenue Agent.

This is to certify the foregoing notice was served upon Mr. Fred Simon, Attorney, for Southwest Consolidated Corporation, in person at his residence 225 Merrick Street, Shreveport, La., 6.15 PM, November 25th, 1939.

(signed) A. R. LACEY

Internal Revenue Agent.

58

57

Received

U. S. Board of Tax Appeals

Nov 25 1939

Form 7951-A

Postal Telegram

TREASURY DEPARTMENT

Bureau of Internal Revenue

Telegraph Office

5PO W 36 5 EXTRA ANSWER REQUESTED

SY SHREVEPORT LA 1002A NOV 25 1939

CLERK

U. S. BOARD TAX APPEALS

WASHINGTON DC

WILL APPRECIATE YOU ADVISING BY WIRE COLLECT IF APPEAL HAS BEEN FILED BY COMMISSIONER IN SOUTHWEST CONSOLIDATED CORPORATION CASE DOCKET NO. 93,321 STOP UNDERSTAND TIME FOR APPEAL WILL EXPIRE TODAY

SOUTHWEST CONSOLIDATED CORPN

901 SLATTERY BUILDING

SHREVEPORT LOUISIANA

58 BUREAU OF INTERNAL REVENUE

TELEGRAPH OFFICE

1939 NOV 25 PM 1 01

From U. S. BOARD OF TAX APPEALS

COLLECT

NOV. 25, 1939

SOUTHWEST CONSOLIDATED
CORPORATION,

901 SLATTERY BUILDING,

SHREVEPORT, LOUISIANA.

RETEL COMMISSIONER FILED APPEAL SOUTHWEST CONSOLIDATED CORPORATION TODAY

B. D. GAMBLE,

CLERK

93321 jd

BDG

59 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Board of Tax Appeals

Filed Apr 24 1940

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent on Review.	B. T. A. Docket No. 93321

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Fifth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.

2. Pleadings:

   (a) Petition

   (b) Answer to petition.

3. Order changing title of proceeding together with motion of taxpayer to change title.

4. Memorandum opinion entered August 25, 1939.

5. Decision entered August 25, 1939.

6. Petition for review.

7. Notices of filing petition for review.

8. Telegram dated November 25, 1939, addressed to Board from taxpayer, together with telegram of same date from Board to taxpayer.

60 9. This praecipe.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted and the said praecipe agreed to this 12 day of April, 1940.

(Signed) A. C. NEWLIN

Attorney for Respondent on Review.

UNITED STATES BOARD OF TAX APPEALS

WASHINGTON

COMMISSIONER OF INTERNAL REVENUE, Petitioner, v. SOUTHWEST CONSOLIDATED CORPORATION, Respondent.	Docket No. 93321

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 60, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 30th day of April 1940.

B. D. GAMBLE

(Seal) Clerk,

United States Board of Tax Appeals.

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

Argument and submission

Extract from the Minutes of December 4th, 1940

No. 9524

COMMISSIONER OF INTERNAL REVENUE

v.

SOUTHWEST CONSOLIDATED CORPORATION

On this day this cause was called, and, after argument by Samuel O. Clark, Jr., Esq., Assistant Attorney General, for petitioner, and A. Chauncey Newlin, Esq., for respondent, was submitted to the Court.

Opinion of the Court filed April 19, 1941

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 9524

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SOUTHWEST CONSOLIDATED CORPORATION, RESPONDENT

Petition for review of decision of the United States Board of Tax Appeals (District of Louisiana)

(April 19, 1941)

Before FOSTER, HUTCHESON, and HOLMES, Circuit Judges

FOSTER, Circuit Judge: Respondent, Southwest Consolidated Corporation, acquired all the assets of Southwest Gas Utilities Corporation, in June 1934, through the medium of a bondholders' committee in a reorganization to which both corporations were parties. In making returns for income and excess-profits taxes for 1934 and 1935 respondent claimed losses for certain worthless assets charged off and took the cost of the assets to the old cor-

poration as a basis for determining loss or gain. The Commissioner disallowed the deductions; held there had been no tax-exempt reorganization; that the transfer was in fact a purchase from the bondholders' committee, a third person; that respondent acquired the assets of the old company at the price they were bid in by the bondholders' committee and was not entitled to take their cost to the old company as a basis for determining gain or loss; and determined deficiencies. The Board of Tax Appeals reversed the Commissioner, holding there had been a tax-exempt reorganization under the provisions of Sections 112 and 113 of the Revenue Act of 1934;[1] relying upon Commissioner vs. Kitselman, 89 F. (2d) 458, certiorari denied, 302 U. S. 708; Commissioner vs. Newberry Lumber & Chemical Co., 94 F. (2d) 447, and various of its own decisions, in which it was held that the bond-

---

[1] SEC. 112. RECOGNITION of GAIN or LOSS.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in Kind.—

* * * * * * *

(4) Same-Gain of Corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to Corporation Controlled by Transferor.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * * *

(g) Definition of Reorganization.—As used in this section and section 113—

(1) The term "reorganization" means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, * * *

* * * * * * *

SEC. 113. ADJUSTED BASIS for DETERMINING GAIN or LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

(7) Transfers to Corporation Where Control of Property Remains in Same Persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as to the consideration in whole or in part for the transfer.

(8) Property Acquired by Issuance of Stock or as Paid-In Surplus.—If the property was acquired after December 31, 1920, by a corporation—

(A) By the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities, or

(B) As paid-in surplus or as a contribution to capital,

Then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

By Section 112 (g) (1) "The term 'reorganization' means * * * (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: * * * of substantially all the properties of another corporation."

holders of an insolvent corporation, after default have a pecuniary interest in the assets.

As the opinion of the Board is not published it is necessary to review the material facts. On May 1, 1932, Southwest Gas Utilities Corporation defaulted in the payment of interest on certain of its bonds, maturing in 1943. It had outstanding 171,915 shares of common stock, 32,244 shares of preferred stock, $2,871,500 of said first lien bonds, secured by pledge of certain assets, including stocks and bonds of subsidiary companies, $126,000 convertible gold notes, unsecured, and $31,945 of other unsecured claims.

A bondholders' committee was organized and about 85 percent of the outstanding bonds were deposited with it. Members of this committee became directors of the company and after October 7, 1932, constituted a majority of the board. On April 10, 1933, a bill in equity was filed in the Court of Chancery, in Newcastle, Delaware, on which receivers were appointed in March 1934. The bondholders' committee was permitted to intervene and a plan of reorganization was proposed and adopted. Under it a new company, respondent, was incorporated, with the right to acquire by direct purchase or foreclosure the assets of the old company. The new company had a financial setup of 200,000 shares of common stock, par value $1.00 or such par value as might be given them, 2880 Class A option warrants and 50,000 Class B option warrants. The option warrants carried the right to buy common stock at respectively $6.00 and $10.00 per share, increasing yearly up to and including 1938. They were doubtless intended to bring in new money and had some present value, which would increase if the company prospered. Based on the fair market value of the assets acquired, the stock of the new company had a book value of $8.85 a share for the whole authorized stock and about $35.00 per share for the amount issued. But, as they did not of themselves transfer any interest in the new company, they may be disregarded in deciding the case.

Pursuant to the plan of reorganization by order of the chancery court, the assets pledged as security for the bonds were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the bondholders' committee at the price of $660,000. The unpledged assets were sold at public auction on December 16, 1934, for $92,000 and they were also bid in by the bondholders' committee. The cost to the old corporation of these assets was $8,995,724 and their fair market value was $1,766,694. These sales were confirmed by the chancery court and all the assets were transferred to the new corporation in exchange for its stock and warrants. In order to effect the exchange of assets respondent issued 49,286 shares of common stock, 2,760 Class A and 18,445 Class B

warrants. Those participating in the plan held $2,450,500 of bonds, $126,000 of notes, 17,297 shares preferred stock (over 53%) and 57,470 shares common stock (over 33%) of the old company. They received 49,224 shares common stock (over 99%) of the new company, 2,140 Class A and 18,445 Class B warrants. Non-participating security holders holding $421,000 of bonds and $19,000 of notes received $106,684 in cash.

From the above recited facts it is apparent the case is similar to those considered in the Kitselman and Newberry cases, *supra*, but is somewhat stronger in favor of the taxpayer because the bondholders agreeing to the plan of reorganization also held substantial stock in the old company.

However, the Commissioner relies upon the case of LeTulle vs. Scofield, 308 U. S. 415 as overruling those cases and demanding a contrary decision in this case. We cannot agree with this contention. In the LeTulle case the transferor received only securities of the transferee, the reverse of the situation in this case, and it was held that in the absence of stock control the transferor became merely a debtor of the transferee, retained no stake in the enterprise, and did not have a continuing pecuniary interest in the assets transferred. The case may be easily distinguished and we do not consider it controlling. The Commissioner also cites Comissioner vs. Bondholders' Committee, Malborough Inv. Co. and Commissioner vs. Malborough House, Inc., . . . F. (2d) . . ., decided after this case was submitted. Those cases may be distinguished from the case at bar. In them apparently there was no initial plan of reorganization but there were a series of happenings from which the Board of Tax Appeals inferred the existence of a plan. We do not find those decisions persuasive when applied to the facts before us.

There is no doubt in this case there was a reorganization in good faith pursuant to a plan adopted by a large majority of all the parties in interest, bondholders, noteholders, stockholders, and even unsecured creditors. It was proposed and worked out by the bondholders' committee and was approved by the Court having custody of the property. It cannot be said the bondholders' committee was a third person. When the plan of reorganization was proposed and adopted the committee was in complete control of the old company. It must be presumed they constituted a majority of the Board of Directors with the consent of the stockholders. The bondholders had a pecuniary interest in the assets of the old company to the exclusion of all others. Immediately after the transfer they were in complete control of the transferee and their pecuniary interest in the assets continued. In effect, the committee was the agent of the old company in the transfer of the assets. When they bid them in at public auction they held

them as trustee for the new company. In principle and in substantial results the transfer was the same as if it were direct from the old company.

The judgment of the board is affirmed.

Judgment

Extract from the Minutes of April 19th, 1941

No. 9524

COMMISSIONER OF INTERNAL REVENUE

v.

SOUTHWEST CONSOLIDATED CORPORATION

This cause came on to be heard on the petition of Commissioner of Internal Revenue for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that the judgment of the said United States Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Clerk's Certificate

UNITED STATES OF AMERICA,
United States Circuit Court of Appeals, Fifth Circuit.

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 63 to 70 next preceding this certificate contain full, true, and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 9524, wherein Commissioner of Internal Revenue is petitioner, and Southwest Consolidated Corporation is respondent, as full, true, and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 62 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 7th day of July, A. D. 1941.

OAKLEY F. DODD,
Clerk of the United States Circuit Court of Appeals, Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1941

Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1941

FILE COPY

JUL 19

No. 280

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SOUTHWEST CONSOLIDATED CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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CITATIONS

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401705—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SOUTHWEST CONSOLIDATED CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit entered in the above case on April 19, 1941, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 31–45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63–67) is reported in 119 F. (2d) 561.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 19, 1941 (R. 67). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to plan, corporate assets were bought in by a bondholders' committee at equity foreclosure and receivership sales. The property was transferred to the taxpayer, a new corporation, in exchange for stock which was distributed to participating creditors, and for stock purchase warrants which were distributed in part to creditors and in part to former stockholders. The question is whether the basis for computing gain or loss upon the subsequent disposition, etc., of the assets by the new corporation is the same as it would be in the hands of the old corporation under Section 113 (a) (7) of the Revenue Act of 1934. The answer depends upon whether the acquisition of the assets by the new corporation constituted a "reorganization" within Section 112 (g) (1).

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 10–12.

STATEMENT

Southwest Gas Utilities Corporation, the taxpayer's predecessor corporation (hereafter referred to as Utilities) had outstanding in 1932, $2,871,500 face amount of 6½% First Lien and Secured Sinking Fund Gold Bonds, together with unsecured claims, preferred stock, and common stock. Upon default in the interest payment on the bonds due May 1, 1932, a bondholders' committee was formed, which obtained the deposit of approximately 85% of the bonds. Members of the committee later became directors of Utilities and after October 7, 1932, were in control of the company (R. 31–32).

The following year, receivers were appointed by the Delaware Chancery Court in a consent proceeding (R. 32). In March 1934 a plan was proposed. The plan provided for the formation of a new company, which would acquire the assets of Utilities in exchange for its common stock and its Class A and Class B stock purchase warrants.[1] The common stock would be issued pro rata to the old bondholders, except for a small portion which, together with the Class A warrants, would be issued to unsecured creditors. The Class B warrants would be issued to the preferred and common stockholders (R. 33–34).

[1] The Class B warrants provided a higher purchase price, but both classes expired in 1938 (R. 33).

On May 11, 1934, the Chancellor issued a decree approving the plan. Thereupon, pursuant to the plan and to court order, the assets pledged as security for the bonds were sold at foreclosure sale on June 25, 1934, and were bid in by the bondholders' committee for $660,000. The unpledged assets were sold at public auction on June 18, 1934, and were bought by the committee for $92,000 (R. 34). The fair market value of the assets at this time was $1,766,694.98 (R. 38).

The taxpayer was formed on June 27, 1934; thereafter the committee transferred Utilities' assets to it; and the stock and warrants were distributed pursuant to the plan (R. 31, 38). Non-participating creditors received a pro rata distribution in cash (R. 37).

The cost basis in the hands of Utilities of the assets acquired by the taxpayer had been $8,995,724.91 (R. 38). The taxpayer used this basis in computing gains and losses on the acquired assets in its income and excess-profits tax returns for the period June 27, 1934, to December 31, 1934, and for the calendar year 1935. The Commissioner, in determining deficiencies, used as the basis the cost of the assets to the committee, namely, the aggregate of $752,000 paid for them at the foreclosure and receivership sales (R. 38–40).

The Board of Tax Appeals, rejecting the Commissioner's position, decided that there was no deficiency for either year (R. 46). The court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's assets had been acquired in connection with a "reorganization" of Utilities and that therefore their basis was the cost to that company.

(2) In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales.

(3) In sustaining the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

This case presents a question of general importance in the administration of the revenue laws as well as a conflict among the circuits.

1. This is one of a number of test cases that the Government has pressed following this Court's decisions in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527. Those decisions held that a transfer of assets or stock of one corporation to another in exchange for bonds or other obligations of the transferee did not constitute a "reorganization" within the meaning of the revenue acts. The Court ruled that the transfer could qualify as a reorganization only if there was a continuity of proprietary interest in the two corporations, and that the mere fact that the old stockholders became creditors of the new corpora-

tion was not sufficient. The instant case presents the precise converse of the *LeTulle* and *Tyng* cases. Here, the stockholders of the new corporation were the bondholders of the old.

The Government has taken the position that the difference is immaterial and has so contended in a series of test cases after the *LeTulle* and *Tyng* decisions.[2] In view of the large number of readjustments of corporate structures in the last decade where the creditors of a corporation became the stockholders of a new corporation which succeeded to the business of the old, the issue is obviously one of general fiscal importance.[3]

---

[2] The fact that stock warrants in the new corporation had been issued to the stockholders in the old is immaterial here, for, as the court below properly recognized (R. 65), the warrants did not create any interest in the new corporation. This follows *a fortiori* from the *Tyng* case where convertible obligations were held not to create a proprietary interest.

[3] In addition to the instant case, the issue is raised in *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511 (C. C. A. 9th), pending on petition for certiorari, Nos. 128, 129, 1941 Term; *Commissioner* v. *Palm Springs Holding Corp.* (C. C. A. 9th), decided May 14, 1941, not yet officially reported but found in 1941 C. C. H., Vol. 4, par. 9470; *Commissioner* v. *Alabama Asphaltic Limestone Co.* (C. C. A 5th), decided May 5, 1941, not yet officially reported but found in 1941 C. C. H., Vol. 4, par. 9452; *Commissioner* v. *Meyer Buchman*, pending on appeal to C. C. A. 2d; *Commissioner* v. *New Haven & Shore Line Ry. Co.*, pending on appeal to C. C. A. 2d; *Commissioner* v. *New President Corp.*, pending on appeal to C. C. A. 8th; *Commissioner* v. *James Q. Newton Trust*, pending on appeal to C. C. A. 10th; *Commissioner* v. *Cement Investors, Inc.*, pending on appeal to C. C. A. 10th.

2. In holding the *LeTulle* and *Tyng* cases inapplicable, the decision below is in conflict with the decisions in two of the test cases recently decided by the Circuit Court of Appeals for the Ninth Circuit. *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511; *Commissioner* v. *Palm Springs Holding Corp.*, decided May 14, 1941.[4] The taxpayer has petitioned for certiorari in the *Marlborough* case, Nos. 128, 129, 1941 Term, and the Government has filed a memorandum not opposing.

The court below professed to distinguish the *Marlborough* decision on the ground that it involved no initial plan of reorganization but a series of happenings from which the Board of Tax Appeals inferred the existence of a plan. The distinction is without substance, however, since the Circuit Court of Appeals for the Ninth Circuit, in deciding the *Marlborough* case, accepted the Board's finding that there was a plan; and in any event, a unifying contract is not required. Cf. *Helvering* v. *Elkhorn Coal Co.*, 95 F. (2d) 732, 738 (C. C. A. 4th), certiorari denied, 305 U. S. 605. Moreover, even if the distinction were valid, it would not resolve the conflict between the two circuits, in view of the decision in the *Palm Springs*

[4] In accord with the decision below among the recent group of cases, however, is *Commissioner* v. *Alabama Asphaltic Limestone Co.*, decided by the court below on May 5, 1941, in which the Government intends to petition for certiorari.

case, where the record shows the existence of a formal plan.

Conversely, the Circuit Court of Appeals for the Ninth Circuit in the *Palm Springs* case professed to distinguish the instant case on the ground that "stock of the transferee was exchanged for stock, as well as bonds, of the transferor, thus permitting the transferor's stockholders to retain a proprietary interest in the corporate enterprise." This is a misconception, probably stemming from the fact, noted by the court below, that some of the bondholders agreeing to the plan also held stock in the old company. Stockholders of the old corporation, *qua* stockholders, received only stock purchase warrants.[5] None of the creditors participated in the new company by reason of their stock holdings. Although the court below intimated that some weight should be attached to this duality of holding, the circumstance is properly of no significance.

3. The decision of the court below is also inconsistent with the plain language of the statute. The court apparently regarded the transaction as a "reorganization" within the definition either of Clause B or Clause C of Section 112 (g) (1) of the Revenue Act of 1934, without making it clear

[5] Neither warrants nor any other securities were issued to former stockholders in the *Marlborough*, *Palm Springs*, or *Alabama Asphaltic* cases.

whether its reliance was on one or both. Even under the reasoning of the court below, Clause B is inapplicable because, in view of the warrants, the exchange was not made "solely" for voting stock. Clause B is also inapplicable because the assets acquired were not, at the time of acquisition, the assets of another corporation. Clause C is inapplicable first, because the transfers were not made by the old corporation, but by the indenture trustee and the receivers (cf. *United States* v. *Galveston-Houston Electric Co.*, 84 F. (2d) 516 (C. C. A. 1st), certiorari denied, 299 U. S. 590), and secondly, because neither the old corporation nor its stockholders were thereafter in "control" of the transferee.*

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition should be granted.

CHARLES FAHY,
Acting Solicitor General.

JULY 1941.

---

* The court below did not discuss in its opinion the alternate argument that this transaction was a reorganization within the definition of Clause D or E, presumably recognizing that these clauses were patently inapplicable. Similarly, the court did not discuss the alternate argument that Section 113 (a) (8) and (b) (5) of the Act applied. While these sections permitted the taxpayer the basis of the assets in the hands of the committee, they are inapplicable on their face with respect to the initial transfer from the corporation.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(U. S. C., Title 26, Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation where Control of Property Remains in Same Persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock

or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property acquired by Issuance of Stock or as Paid-in Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

(U. S. C., Title 26, Sec. 113.)

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No. 286

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SOUTHWEST CONSOLIDATED CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 31–45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63–67) is reported in 119 F. (2d) 561.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 19, 1941 (R. 67). The petition for a writ of certiorari was filed July 19, 1941, and was granted on October 13, 1941. The jurisdiction of this Court rests on Section 240 (a) of the Ju-

dicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to plan, corporate assets were bought in by a bondholders' committee at equity foreclosure and receivership sales. The property was transferred to the taxpayer, a new corporation, in exchange for stock which was distributed to participating creditors, and for stock purchase warrants which were distributed in part to creditors and in part to former stockholders. The question is whether the basis for computing gain or loss upon the subsequent disposition, etc., of the assets by the new corporation is the same as it would be in the hands of the old corporation under Section 113 (a) (7) of the Revenue Act of 1934. The answer depends upon whether the acquisition of the assets by the new corporation constituted a "reorganization" within Section 112 (g) (1).

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 31–40.

STATEMENT

Southwest Gas Utilities Corporation, the taxpayer's predecessor corporation (hereafter referred to as Utilities) had outstanding in 1932, $2,871,500 face amount of 6½% First Lien and Secured Sinking Fund Gold Bonds, together with unsecured claims, preferred stock, and common

stock. Upon default in the interest payment on the bonds due May 1, 1932, a bondholders' committee was formed, which obtained the deposit of approximately 85% of the bonds. Members of the committee later became directors of Utilities and after October 7, 1932, were in control of the company (R. 31–32).

The following year, receivers were appointed by the Delaware Chancery Court in a consent proceeding (R. 32). In March 1934 a plan was proposed. The plan provided for the formation of a new company, which would acquire the assets of Utilities in exchange for its common stock and its Class A and Class B stock purchase warrants.[1] The common stock would be issued pro rata to the old bondholders, except for a small portion which, together with the Class A warrants, would be issued to unsecured creditors. The Class B warrants would be issued to the preferred and common stockholders (R. 33–34).

On May 11, 1934, the chancellor issued a decree approving the plan. Thereupon, pursuant to the plan and to court order, the assets pledged as security for the bonds were sold by the indenture trustee at foreclosure sale on June 25, 1934, and were bid in by the bondholders' committee for $660,000. The unpledged assets were sold at public auction on June 18, 1934, and were bought by

[1] The Class B warrants provided a higher purchase price, but both classes expired in 1938 (R. 33).

the committee for $92,000 (R. 34). The fair market value of the assets at this time was $1,766,694.98 (R. 38).

The taxpayer was formed on June 27, 1934; thereafter the committee transferred Utilities' assets to it, and the stock and warrants were distributed pursuant to the plan, as follows (R. 31, 36):

	Utilities	Taxpayer		
		Securities Issued		
	Amount Participating	Common Stock	A Warrants	B Warrants
Bonds	$2,450,500.00	49,010 shares		
Notes	107,000.00	214 shares	2,140	
Other Unsecured Claims	31,945.42	62 shares	620	
Preferred Stock	17,297 shares			17,297
Common Stock	57,470 shares			1,148¾₀

Non-participating holders of $421,000 of bonds and $19,000 of notes received a pro rata distribution of $106,684.06 in cash (R. 37).

The cost basis in the hands of Utilities of the assets acquired by the taxpayer had been $8,995,724.91 (R. 38). The taxpayer used this basis in computing gains and losses on the acquired assets (e. g., in computing deductions for worthless securities and bad debts, R. 39) in its income and excess-profits tax returns for the period June 27, 1934, to December 31, 1934, and for the calendar year 1935. The Commissioner, in determining deficiencies, used as the basis the cost of the assets to the committee, taking, as representing the cost,

the aggregate of $752,000 paid for them at the foreclosure and receivership sales (R. 38–40).

The Board of Tax Appeals, rejecting the Commissioner's position, decided that there was no deficiency for either year. (R. 46.) The court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's assets had been acquired in connection with a "reorganization" of Utilities and that therefore their basis was the cost to that company.

(2) In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales.

(3) In sustaining the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The effect of the readjustment was to liquidate the stockholders' investment in the enterprise and to transfer the ownership of the company to the participating creditors. In these circumstances, there is no practical justification for permitting the new company to continue to use the old basis. That basis reflected the investment cost of the properties while indirectly owned by the old stockholders, but it bears no relationship to the cost of the properties to the new owners. Consequently, the result of the taxpayer's position is an obvious tax windfall.

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The Government's position is that a new basis should be employed measured by the cost of the assets to the creditors when they take over the properties. This provides a sound basis for computing the tax and at the same time is fair to the creditors since depreciation in the value of their individual investments would be reflected in a capital loss upon exchange of their claim for the new stock.

Considered against this background, the rule of *LeTulle* v. *Scofield*, 308 U. S. 415, is clearly applicable. That case establishes the rule that where the stockholders of a corporation retain only a creditor position in a transferee corporation, there is lacking the continuity of proprietary interest required for a reorganization within the purview of the statute. Although that case involved a transfer of equity interests for a creditor's position, rather than the converse presented here, the underlying considerations are the same. The situation is not altered by the existence of the warrants, since they do not create a proprietary interest but merely confer a right to reinvest in the enterprise upon a new cash payment.

Furthermore, this transaction does not qualify as a reorganization or a tax free exchange even within the literal language of the reorganization definitions or of Section 112 (b) (5). Nor does the fact that the corporation was insolvent mean either that the creditors were the equivalent of the "corporation" or its "stockholders" before the fore-

closure sale, or that prior thereto they had a proprietary interest within the contemplation of *LeTulle* v. *Scofield, supra.* The identifiable event, legally effecting the shift in the character of their interests, was the foreclosure sale. Our conclusions are supported by the legislative purpose underlying the reorganization and nonrecognition provisions.

ARGUMENT

THE BASIS OF THE TAXPAYER'S ASSETS IS NOT THE SAME AS IN THE HANDS OF THE OLD CORPORATION

Introductory.—This case presents broadly the problem of the tax consequences of corporate readjustments in which creditors of the company become the stockholders of the new corporation which succeeds to the business of the old. The immediate issue is whether the new corporation is entitled to use the basis which the properties had in the hands of the old company in determining gain or loss upon the disposal of various of these assets.[2]

[2] The identical problem also arises in determining depreciation or depletion allowances, since the same basis is used for these purposes. Revenue Act of 1934, Section 114 (a). That is the immediate issue presented in the three companion cases: *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511 (C. C. A. 9th), and *Commissioner* v. *Palm Springs Holding Corp.*, 119 F. (2d) 846 (C. C. A. 9th), certiorari granted October 13, 1941, Nos. 128, 129, and 503, respectively; and *Commissioner* v. *Alabama Asphaltic Limestone Co.*, 119 F. (2d) 819 (C. C. A. 5th), certiorari granted October 13, 1941, No. 328. It is also

The readjustment was effected in accordance with the familiar practices employed in equity receivership proceedings. After the appointment of receivers in a consent state court proceeding, a bondholders' committee (which previously had

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presented in *Helvering* v. *New Haven & S. L. R. Co.*, 121 F. (2d) 985 (C. C. A. 2d), pending on the Government's petition for certiorari, No. 780, this Term. The other major question, which is correlative, is whether gain or loss will be recognized upon exchanges of the old securities for the new. That issue is presented in *Commissioner* v. *Cement Investors, Inc.*, 122 F. (2d) 380 (C. C. A. 10th), *Commissioner* v. *James Q. Newton Trust*, 122 F. (2d) 416 (C. C. A. 10th), and *Commissioner* v. *James Q. Newton, Jr.*, 122 F. (2d) 416 (C. C. A. 10th), now pending on petitions for certiorari, Nos. 644, 645, and 646 (this Term), respectively.

The problem is not limited to readjustments effected through receivership or foreclosure proceedings. The *Alabama Asphaltic* case, for example, involved a bankruptcy proceeding; the *Cement Investors* and *Newton* cases, a Section 77B proceeding.

Additions to the Bankruptcy Act of 1898 made by the Chandler Act (Act of June 22, 1938, c. 575, 52 Stat. 840), as further amended by the Act of July 1, 1940, c. 500, 54 Stat. 709, Section 1, now require with respect to proceedings under Section 77B or Chapter X that the basis of the debtor's property or the basis of property "transferred to any person required to use the debtor's basis in whole or in part shall be decreased to an amount equal to the amount by which the indebtedness of the debtor * * * has been canceled or reduced by a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan." Bankruptcy Act of 1898, as amended, Sections 270, 276c (3) (U. S. C. Supp. V, Title 11, Sections 670, 676). See Regulations 101, Article 113 (b)-2, and Regulations 103, Section 19.113 (b) (1)-2, as amended by T. D. 5003, 1940-2 Cum. Bull. 107; G. C. M. 22528, 1941-8 Int. Rev. Bull. 2. Similar

obtained deposits of approximately 85% of the bonds) promulgated a plan of reorganization. The substance of the plan was that the creditors would take over the ownership of the company through the medium of a new corporation. The stockholders would receive no participation in the new company except upon making a cash payment in exercise of stock purchase warrants to be distributed to them. In order to effect the plan, the Debtor's free assets were sold at receivership sale and the pledged assets, at foreclosure sale; in each instance, they were bid in by the committee. Presumably deposited bonds were applied in part payment, and nonassenting creditors received a pro rata cash distribution. Thereafter, the assets were transferred to the taxpayer, the new corporation, in exchange for stock which was distributed to participating creditors, and for stock purchase warrants which were distributed in part to creditors and in part to former stockholders.

The taxpayer's right to use the old basis of $8,995,724.91 is dependent upon its showing that it comes within one of the exceptions to the gen-

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provisions apply with respect to compositions under Sections 12 or 74 of the Bankruptcy Act (U. S. C., Title 11, Sections 30 and 202), arrangements under Chapter XI, and real property arrangements by persons other than corporations under Chapter XII. Act of June 22, 1938, Sections 396, 399 (4), 522, 526 (c) (U. S. C. Supp. V, Title 11, Sections 796, 799, 922, 926), as amended by the Act of July 1, 1940. See Regulations, *supra*.

eral rule that the basis of property should be its cost. Sections 113 (a) and 114 (a) of the Revenue Act of 1934 (Appendix, *infra*); Regulations 86, Articles 113 (a)–2 and 113 (b)–1 (Appendix, *infra*). Alternate claims are made: *first*, that the assets were acquired in a reorganization within the meaning of Section 112 (g) (1) of the Revenue Act of 1934 (Appendix, *infra*) and that therefore the old basis should be used under Section 113 (a) (7) of the Act; and, *secondly*, that the assets were acquired in connection with a transaction described in Section 112 (b) (5) and that therefore Section 113 (a) (8) is applicable.

There has been uncertainty as to the applicability of the reorganization provisions to situations of this type, and in the past the Commissioner has taken the position in each case that was necessary to protect the revenues. See *e. g., Commissioner* v. *Kitselman*, 89 F. (2d) 458 (C. C. A. 7th), certiorari denied, 302 U. S. 709; *Commissioner* v. *Newberry L. & C. Co.*, 94 F. (2d) 447 (C. C. A. 6th).[2]

[2] The *Newberry* case raised a basis question; the *Kitselman* case, a question of recognition of loss upon exchange of the creditors' claims for stock of the new company. The Commissioner contended that there was not a reorganization in the *Newberry* case and that there was in the *Kitselman* case. The Board of Tax Appeals in both cases had held that there was no reorganization. *Newberry* v. *Commissioner*, 33 B. T. A. 150; *Kitselman* v. *Commissioner*, 33 B. T. A. 494. Contrary decisions previously had been reached in similar situations (*First National Bank of Champlain, N. Y.* v. *Commissioner*, 21 B. T. A. 415; *Rockford Dairy, Inc.*, v. *Commissioner*, 26 B. T. A. 501), but the Board,

That uncertainty was attributable in part to the doubts raised by *Helvering* v. *Watts*, 296 U. S. 387, as to the status of bondholders in corporate reorganizations. But that uncertainty has since been largely dispelled by *LeTulle* v. *Scofield*, 308 U. S. 415, which established the basic principle that a continuity of proprietary interest is necessary to a reorganization for income tax purposes, and that a creditor position is not such an interest. Accord: *Helvering* v. *Tyng*, 308 U. S. 527, reversing *Commissioner* v. *Tyng*, 106 F. (2d) 55 (C. C. A. 2d), rehearing denied, 309 U. S. 694. Accordingly upon reexamination of the problem in the light of these decisions, it is the Government's position that readjustments of the type presented here are not properly within the reorganization provisions. As we shall endeavor to show, the claims to an exception advanced by the taxpayer do not meet the test laid down in the *LeTulle* case, they are not supported by the language of the statute, and they run counter to the underlying legislative intent.

A. *Practical Aspects of Problem*

The legal questions should be considered against the background of the practical tax aspects of the

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in the *Kitselman* case, refused to follow its earlier holdings, stating that to the extent they were in conflict with the requirement of a continuity of interest laid down in *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462, and *Cortland Specialty Co.* v. *Commissioner*, 60 F. (2d) 937 (C. C. A. 2d), certiorari denied, 288 U. S. 599, they were no longer authoritative. The two Circuit Courts of Appeal, however, held that there was a reorganization.

problem. As the facts of the instant case emphasize, there is no equitable or business justification for permitting the owners of the new company to continue to use the old basis.

Where a corporate transaction results in a continuation of an existing investment merely in a different form, it is understandable that the owners of that investment should be permitted to retain the same basis for tax purposes. Regulations 86, Article 112 (g)-1. (Appendix, *infra.*) That basis continues to reflect the investment cost of the properties still indirectly owned by the same persons. Cf. *Prairie Oil & Gas Co.* v. *Motter*, 66 F. (2d) 309, 312 (C. C. A. 10th). Accordingly, if the stockholders' interests in the old company had been continued in the taxpayer, sound support for the use of the old basis of approximately $9,000,000 would appear.

This readjustment, however, liquidated the investment of the stockholders. The warrants, distributed to those stockholders who bothered to take them,* provided only a privilege to buy into the new enterprise upon a new cash payment. The result was a clean break in the ownership of the company, with the participating creditors now taking over the equity interest.

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* The record shows (p. 36) that of the 171,915 shares of common stock outstanding, only 57,470 shares participated in the plan; of 32,244 shares of preferred stock outstanding, only 17,297 shares participated. In other words, holders of about two-thirds of the common stock and one-half of the preferred stock did not make the exchange.

Plainly the old basis bears no relationship to the cost of the properties to these new owners. They acquired the assets at the judicial sale in substance by paying for them with their claims of approximately $2,500,000 face amount, which were worth no more than $1,766,694.98, the total market value of the underlying properties. Yet, if the taxpayer is sustained, its gains or losses for tax purposes will be measured on the assumption of an investment of approximately $8,900,000. In comparable situations, depreciation or depletion would be computed on a similarly inflated basis. This means an obvious tax windfall.

In contrast, the Government's position reaches a result that is sound and fair. A new cost basis is adopted for the taxpayer measured by what the creditors pay when they become the owners.[5] As a

[5] The Commissioner previously has contended that the cost should be measured by the bid price. The regulations, applicable to mortgage foreclosure situations generally, however, provide that if a "creditor buys in mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property * * * and the fair market value of the property"; and that the basis for determining gain or loss in the event of resale "is the fair market value of the property at the date of acquisition." Regulations 86, Article 23 (k)–3. *Commissioner* v. *West Production Co.*, 121 F. (2d) 9 (C. C. A. 5th), certiorari denied, November 10, 1941. In *Commissioner* v. *New President Corporation*, 122 F. (2d) 92, the Circuit Court of Appeals for the Eighth Circuit, while agreeing with the Government that there was no reorganization in a receivership case such as the instant pro-

corollary, gain or loss will be recognized upon the exchange of the claims for stock of the new company since Section 112 (b) (3) will be inapplicable.[6] Thus, measured by the basis of the various claims to the individual creditors (ordinarily, of course, the cost), each creditor will be entitled to a capital loss which will reflect the depreciation in the value of his original investment.[7] Consequently, an adjustment is made on an individual basis which takes into account both the fact that the new basis will be less than the full amount of the existing claims, and that sales or other transfers of the claims probably have taken place since their original creation.[8]

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ceeding, held that this regulation governed in determining the basis for measuring gain upon sale of the property acquired by the new corporation. The Government has not sought review of this decision.

Accordingly, it is now our position that the bid price is only presumptively the cost of the property to the committee, and that the presumption may be rebutted by appropriate evidence.

[6] Section 112 (b) (3) of the Revenue Act of 1934 provides:

"(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

[7] By the same token, gain will be recognized to the extent that any creditor may have purchased the claims at depressed prices and has actually realized a gain upon the exchange for the new stock. See fn. 2, *supra*.

[8] Due to the limitations which the statutes place upon capital losses (*e. g.*, Revenue Act of 1934, Sections 117 (a)

B. *Absence of Continuity of Proprietary Interest*

In the light of these practical considerations, the applicability to this situation of the test of a reorganization, established by this Court in *LeTulle* v. *Scofield, supra,* seems clear. That decision establishes the rule that there is no reorganization within the purview of the statute where the owners of a transferor corporation receive in exchange only a creditor position in the transferee corporation. Even though long term bonds are retained, this is not sufficient to establish the necessary continuity of proprietary interest. If that continuity is lacking, the transaction is not a reorganization, even though it may otherwise be fitted into the literal language of the statutory definition. Regulations 86, Article 112 (g)–1.[9] In the instant case, where the transfer shifted the ownership of the equity in the properties from the stockholders to the creditors of the old corporation, the continuity was definitely broken.

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and (d)), the adjustment may not be complete in every case. This is a circumstance, however, which may exist whenever property is sold or exchanged at a loss.

[9] It seems clear that the same rule governs in determining the application of the non-recognition provisions of Section 112 (b) (5). The underlying assumptions of these provisions and the reorganization definition are essentially the same. See *American Compress & Warehouse Co.* v. *Bender*, 70 F. (2d) 655, 657–658 (C. C. A. 5th), certiorari denied, 293 U. S. 607; *Lloyd-Smith* v. *Commissioner*, 116 F. (2d) 642, 644 (C. C. A. 2d), certiorari denied, 313 U. S. 588; Regulations 86, Articles 112 (a)–1 and 112 (g)–1.

In the *LeTulle* case, corporate assets were transferred in exchange for cash and $750,000 in bonds of the acquiring corporation. These bonds were distributed to the stockholders of the transferor in exchange for the stock. The Court, holding that the transaction was not a reorganization and that therefore, the stockholders were taxable upon the gain which they realized, said (pp. 420–421):

> In applying our decision in the *Pinellas* case [*Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462] the courts have generally held that receipt of long term bonds as distinguished from short term notes constitutes the retention of an interest in the purchasing corporation. * * *
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> We are of opinion that the term of the obligations is not material. Where the consideration is wholly in the transferee's bonds, or part cash and part such bonds, we think it cannot be said that the transferor retains any proprietary interest in the enterprise. On the contrary, he becomes a creditor of the transferee; and we do not think that the fact referred to by the Circuit Court of Appeals, that the bonds were secured solely by the assets transferred and that, upon default, the bondholder would retake only the property sold, changes his status from that of a creditor to one having a proprietary stake, within the purview of the statute.

> We conclude that the Circuit Court of Appeals was in error in holding that, as respects any of the property transferred to the Water Company, the transaction was other than a sale or exchange upon which gain or loss must be reckoned in accordance with the provisions of the revenue act dealing with the recognition of gain or loss upon a sale or exchange.

On its facts, the *LeTulle* case involves the converse of the situation now before the Court. There, the stockholders of the transferring corporation surrendered their equity interest and retained a creditor position. Here, the creditors of the transferring corporation surrendered their claims and acquired an equity interest in the new company. The significant fact, however, is that here as in the *LeTulle* case the ownership interest in the transferee company was not retained by the holders of the ownership interest in the transferor. Under the plan, the equity interest of the old stockholders was eliminated. No more than in the *LeTulle* case was the situation one in which an existing proprietary interest was substantially continued under a new corporate form.

This conclusion is not affected by the issuance of the warrants to the former stockholders. The court below properly recognized that their existence was immaterial. Even if we should assume these warrants had a value, as the taxpayer insists, this does not mean that they created a

proprietary interest.[10] The warrants merely gave the old stockholders a right to reinvest in the company at the prices prescribed. That right was even farther removed from a proprietary interest than the rights under the bonds retained by the old stockholders in the *LeTulle* case. Indeed, the fact that the warrants did not create any interest in the new corporation follows *a fortiori* from *Helvering* v. *Tyng, supra.* In that case, the lower court had held that creditor instruments, which were convertible into stock at the option of the owner, provided a continuity of interest. *Commissioner* v. *Tyng,* 106 F. (2d) 55 (C. C. A. 2d). On the authority of *LeTulle* v. *Scofield, supra,* this Court reversed the judgment below *per curiam* (308 U. S. 527) and denied petitions for rehearing based on the specific contention that the convertible feature distinguished these securities. 309 U. S. 694.

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[10] The preferred stockholders had received one class B warrant for each share held and the common stockholders, one Class B warrant for each fifty shares held. These warrants were priced at $10 a share during 1934 and at an increase of $5 each year until expiration in 1938. (R. 33, 34.) As stated above (fn. 4) about two-thirds of the common and one-half of the preferred stock did not make the exchange. Of the warrants actually issued, approximately 75% were allowed to lapse (R. 38).

As against 49,286 shares of the stock of the taxpayer issued to the creditors in exchange for their claims, only 4,623 were issued upon exercise of the Class B warrants issued to the stockholders. An additional 1,760 shares were issued upon exercise of the Class A warrants issued to creditors (R. 35–36, 38).

C. *The Literal Language of the Statute*

Our primary contention, as thus developed, is that this transaction is beyond the purview of the statute because the proprietary interest in the old corporation is not continued in the new. Under the rules laid down in the decided cases, this conclusion would not be altered even though the transaction might otherwise be fitted into the literal language of the statutory provisions. E. g., *LeTulle* v. *Scofield, supra; Pinellas Ice Co.* v. *Commissioner, supra.* In the instant case, however, the taxpayer's claim to the benefit of these special exceptions falls for the further reason that the transaction does not comply with the detailed requirements laid down in the act.

In considering this point, there are two possible analyses of the transaction. On the one hand, emphasis may be placed upon the legal machinery employed. Thus, the transaction would be treated as involving two separate steps: (1) the purchase of the assets by the committee from the receivers and the indenture trustee for the amount of the bid prices; and (2) the committee's transfer of the assets to the new corporation, in return for a distribution of its stock and the stock purchase warrants as the plan provided. On the other hand, the separate steps of the transaction may be disregarded and emphasis placed upon the ultimate result. Thus, the transaction would be regarded simply as a transfer of the old corporation's assets to the new corporation; in return the new corporation would distribute its

securities in accordance with the plan and provide the cash required to pay off dissenters.

1. If the transaction is analyzed as involving two separate steps, it is plain that the statute would not permit the new corporation to use the basis of the old. The first step, the acquisition of the assets by the committee, involved neither an intercorporate transaction, which might conceivably be a reorganization under any of the definitions of Section 112 (g) (1), nor a transfer to a corporation, which might conceivably be said to bring it under Section 112 (b) (5). In the absence of any provision entitling the committee to the old corporation's basis, it follows that the basis to the committee must be their cost.[11] The second step in the transaction, however—the committee's transfer of the assets to the new corporation—would be tax free under Section 112 (b) (5); consequently, the committee's basis carries over to the taxpayer under Section 113 (a) (8).

This is the precise result for which we contend. In this connection, it should be emphasized that these two steps accurately reflect the actual substance of the plan, as it was contemplated that it should be carried out and as in fact it was carried out. The assets were bought in at the sales in behalf of the participants under the plan. The consideration paid the receivers and indenture

[11] Cost would be measured, according to our present position, by the market value of the assets acquired. Fn. 5, *supra*.

trustee for their transfers consisted of the bid price, presumably represented in part by cash and in part by the surrender of deposited bonds. This transaction foreclosed any interests of the former stockholders, and at the same time enabled the assentors to buy out the interests of nonassentors. The second step in the transaction served simply to substitute the new corporation in the place of the committee. In thus succeeding to the committee's interests in the assets it had purchased, the taxpayer was properly entitled to use the committee's basis, namely, the committee's cost. But this fact provides no warrant under the statute, for saying further that the taxpayer, either directly or through the committee, was entitled to use the higher basis in the hands of the old corporation.

2. Even if the plan is analyzed, however, with the emphasis placed upon the ultimate result rather than upon the action taken, the transaction does not qualify as a reorganization or a tax-free transfer entitling the taxpayer to the use of the old basis.

Clause B of Section 112 (g) (1) would not be applicable since it requires that the acquisition by the transferee corporation be *solely* in exchange for voting stock. Here, by hypothesis, cash for dissenters and the stock purchase warrants were also exchanged. The warrants were not stock and they did not confer any voting rights upon their holders; as we have already stated, the fact

that they could be converted into stock upon payment of the purchase price did not make them the same thing.[12]

Clause C requires that the transfer be by a "corporation" and that "after the transfer the transferor or its stockholders or both" be "in control of the" transferee. Even if we assume that the transfer was made by the old corporation, rather than by the receivers and the indenture trustee (but *cf. United States* v. *Galveston-Houston Electric Co.*, 84 F. (2d) 516 (C. C. A. 1st), certiorari denied, 299 U. S. 590), neither the old corporation nor its stockholders were thereafter in control of the new company. That control, as defined in Section 112 (h) requires the "ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." After the transfer, control was not in the old company itself or in its stockholders but in the participating creditors. They received all of the taxpayer's stock (except for the small

[12] The taxpayer has referred to a contrary view expressed by the Commissioner in a letter to The Middle West Corporation, dated January 27, 1937. 1937 CCH Vol. 3, Par. 6118. This conclusion appears erroneous in light of this Court's subsequent determination in *Helvering* v. *Tyng*, *supra*. The letter is not controlling, moreover, since it was neither a formal ruling of the Treasury Department intended to have general application, nor did it represent a long-continued, uniform administrative construction.

fraction issued upon exercise of the warrants).[13] Upon no basis of calculation can it be concluded that 80% of the stock was owned by Utilities stockholders.[14]

For this same reason, the transaction would not fit the requirements of Section 112 (b) (5). The section similarly requires that control be continued in the "transferor." Whether we regard the old corporation, or the receivers and the indenture trustee as the "transferor," the control plainly passed to others.

Lastly, although the taxpayer has argued the contrary, it seems too clear for discussion that the transaction is neither a "recapitalization" under Clause D of the reorganization definition nor a "mere change in identity, form, or place of organization, however effected" under Clause E. The term "recapitalization" obviously refers to an internal readjustment of existing security interests within a corporation, and it may be assumed

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[13] See fn. 10, *supra*. The court below intimated that some weight should be attached to the circumstance that some of the creditors had also been stockholders, and the fact has been emphasized by the taxpayer. But stockholders of the old ucorporation, *qua* stockholders, received only stock-purchase warrants. None of the creditors participated in the new company by reason of their stock holdings. The circumstance that there was this duality is of no significance.

[14] If *all* the stockholders of Utilities had exchanged their stock for the warrants, and if *all* these warrants had been exercised, approximately 35,000 shares of the taxpayer's stock would have been issued to the old stockholders. This would be substantially less than 50% of the total.

that Clause E means no more than it says. It follows without elaboration that a transaction which shifts the entire ownership of an enterprise from its stockholders to a new corporation owned by a majority of its creditors is outside the scope of these provisions.

3. The taxpayer has introduced a third variation by the theory, advanced in the court below, that the bondholders had exchanged their bonds for stock of the new corporation; that this was a transaction described in Section 112 (b) (5); and that therefore the taxpayer had issued its securities "in connection" with such a transaction and was entitled to the basis of the "transferor" under Section 113 (a) (8). Cf. *Commissioner* v. *Cement Investors, Inc., supra.* It is unnecessary to consider in this case the question whether gain or loss would be recognized upon the bondholders' exchanges under Section 112 (b) (5). In the *Cement Investors* and *Newton* cases, which directly involve the issue, the Government contends that they are not. The decisive fact here is that the problem, so far as it affects the application of Section 113 (a) (8), would be relevant only if we were concerned with the basis of the bonds in the hands of a transferee. Even if Section 112 (b) (5) were applicable, in the manner suggested by the taxpayer, it would not follow that the basis of the assets of the taxpayer would be the same as in the hands of the old corporation.

D. *Immateriality of Debtor's Insolvency*

In seeking to avoid the application of the rule laid down in the *LeTulle* case, and as well as to bring this type of situation within the particular language of Clause C, the argument is made that where a corporation has become insolvent, the creditors have in substance become the owners of its property. This view was first adopted in *Commissioner* v. *Kitselman, supra,* and *Commissioner* v. *Newberry L. & C. Co., supra.* These cases, which were decided prior to *LeTulle* v. *Scofield, supra,* held that where properties were bought in by bondholders at equity foreclosure sales, there was a reorganization, although the stock interests were eliminated. Considerable weight was attached to these decisions both by the Board of Tax Appeals and the court below in reaching decisions adverse to the Government in the instant case.[15]

The theory of the *Kitselman* case (89 F. (2d) at p. 461), which the *Newberry* case apparently followed, is that in the event of insolvency (although prior to foreclosure) bondholders are "in actuality and for all practical purposes pretty much the corporation"; that they are "stepped up" to the position of stockholders; that they "supersede the stockholders" and "acquire the stockholders' rights to manage the corporate affairs." From these observations, it was concluded that the bond-

[15] This has likewise been true in the opinions in the companion cases. Fn. 2, *supra.*

holders must be viewed as a "class of 'stockholders' " of the old corporation.

It is true, of course, that under now well-settled principles of reorganization law, the creditors of an insolvent corporation will be entitled to all the assets of the corporation in any fair plan that is evolved. *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106; *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510. It by no means follows, however, that they have such ownership prior to the critical event (whether it be foreclosure or consummation of a plan) which results in their acquisition of the assets. Before that time, the stockholders continue to have certain well-defined rights. If the company is in receivership, they continue to elect the officers and directors of the company. The management may initiate other proceedings, as for example, filing a voluntary petition in bankruptcy or under Section 77B or Chapter X of the Bankruptcy Act. If, at the time of the sale, the value of the assets should turn out to be greater than the creditors' claims, the excess belongs to the stockholders.

For tax purposes, the anticipation of a proprietary interest is not its equivalent. This was brought out by this Court in the *LeTulle* case in its statement that merely because, upon default, "the bondholder would retake only the property sold," this does not change "his status from that of a creditor to one having a proprietary stake, within the purview of the statute." *LeTulle* v. *Scofield*,

308 U. S. 415, 421. The Court reemphasized the point in *Commissioner* v. *Tyng, supra,* by its determination that creditor obligations did not provide a continuity of proprietary interest even though they were convertible into stock at the option of the owner.

The decisions adverse to the Government's position do not deny that under the *LeTulle* case the transfer of a creditor's claim for an ownership interest would, in the absence of insolvency, be outside the application of the reorganization sections. Indeed, that this is so is emphasized in *Helvering* v. *New Haven & S. L. R. Co.,* 121 F. (2d) 985 (C. C. A. 2d).[16] The theory, however, is that in substance this shift has already taken place. Therefore, it is argued, the creditors are already the practical equivalent of owners of the enterprise, and consummation of the plan, by means of the foreclosure sale, provides no substantial change in the existing interests. *Ibid.*

This reasoning reveals the essential fallacy in these decisions from a tax standpoint. It concedes that there has been a shift in the nature of the investment of a character upon which gain or loss should be recognized; that is, a shift from a creditor to an ownership position. It treats that shift,

[16] "* * * there would be no 'reorganization' because the bondholders would receive a different interest in the property from what they had had before, and it was this circumstance, as we understand it, which was determinative in *LeTulle* v. *Scofield, supra* (308 U. S. 415)." *Ibid,* at p. 987.

however, as taking place at a time and in a manner which provides no identifiable incident that may be the taxable event. That incident, we submit, is properly to be found in this type of proceeding in the judicial sale. It is the sale which changes the legal rights (Cf. *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 225), and there is no reason to disregard it.

E. *The Legislative Intent*

Finally, our conclusions that the reorganization and non-recognition provisions are not applicable to readjustments which operate to turn over the corporation's assets to its creditors is required by the plain import of these provisions. These provisions show on their face that they were intended to apply to corporate readjustments in the course of going business operations which require merely the reissuance in another form of securities that evidence the participation of the owners of the enterprise. That is what normally happens in statutory consolidations or mergers, or in recapitalizations, or when there is a mere change in identity, form, or place of organization. None of the types of transactions included in these definitions contemplates the elimination of an ownership interest from participation in the corporate undertaking. On the contrary, they all definitely contemplate proceedings in which the stockholders will continue their participation in the ownership of the enterprise.

This is the legislative purpose which has been embodied expressly in the requirement of Clause C that "control" be continued in the old corporation or its stockholders, and in the requirement of Section 112 (b) (5) that the persons making the transfer continue in "control." It is the same legislative purpose which, we believe, underlies the decisions that have developed judicially the rule requiring a continuity of interest. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378; *LeTulle* v. *Scofield, supra; Cortland Specialty Co.* v. *Commissioner,* 60 F. (2d) 937 (C. C. A. 2nd). For where corporate assets have been transferred in return only for a claim against the transferee, and the proprietary interest of the old stockholders has been eliminated, the transaction is not a continuance in another form, of the original investment but, like an outright sale, is a termination of the investment of the original owners.

Specific recognition of the principle, as expressed by the Court, was given in the Report of House Committee on Ways and Means on the Revenue Act of 1934. The report stated (H. Rep. No. 704, 73d Cong., 2d Sess., p. 13 (1939–1 Cum. Bull. (Part 2) 554, 564)):

> The Supreme Court has indicated that the broad principle underlying these sections is that no taxable profit is realized from a reorganization, if no money passes and if the changes in corporate organization are

> essentially changes only in form, *with the stockholders continuing their former interest in the original enterprise.* [Italics supplied.]

The same general purpose and principle are expressed in the applicable Treasury Regulations. Regulations 86, Article 112 (g)–1.

Determination of the instant case in the light of this underlying principle requires a decision in accordance with our position. The ultimate effect of the plan was to transfer the debtor's assets to assenting creditors in satisfaction of their claims. Cf. *Case* v. *Los Angeles Lumber Co., supra,* at pp. 119–120. In exchange, they acquired all the advantages and benefits of equity ownership—the management and control of the properties and the right to all available earnings and appreciation in value. The stockholders, the prior owners of the property, no longer had any interest in it, simply retaining an option to buy back a partial interest in the company according to the terms of the warrants. Such transactions are entirely comparable to the sale transactions with respect to which the continuity of interest rule has been established. *Pinellas Ice Co.* v. *Commissioner, supra; LeTulle* v. *Scofield, supra.*

CONCLUSION

The judgment of the court below should be reversed with directions that upon remand to the Board of Tax Appeals the deficiency be recom-

puted using as the basis the stipulated market value of the assets acquired.

Respectfully submitted.

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DECEMBER 1941.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) COMPUTATION OF GAIN OR LOSS.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

(U. S. C., Title 26, Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in pro-

portion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(U. S. C., Title 26, Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation where Control of Property Remains in Same Persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property acquired by Issuance of Stock or as Paid-in Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the

amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * * *

(U. S. C., Title 26, Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * * *

(U. S. C., Title 26, Sec. 114.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 112 (a)–1. *Sales or exchanges.*—The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is to be recognized is governed by the provisions of section 112.

The general rule is that the entire amount of such gain or loss is to be recognized.

An exception to the general rule is made by section 112 (b) in the case of certain specifically described exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Act provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

* * * * *

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Act only if the exchange is one which satisfies both (1) the specific description in the Act of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be

shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

To constitute an exchange within the meaning of section 112 (b) the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

* * * * *

ART. 112 (g)-1. *Purpose and scope of exception of reorganization exchanges.—Purpose:* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Act is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Act, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Act are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Act recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Act recognizes as a reorganization the amalgamation (occurring in a specified

way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Act, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

* * * * *

ART. 112 (g)-2. *Definition of terms.*— The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange.

* * * * *

In order to qualify as a "reorganization" under section 112 (g) (1) (B), the aquisi-

tion by the acquiring corporation of the required amount of the stock, or of substantially all the properties, of the other corporation must be in exchange *solely* for all or a part of the *voting stock* of the acquiring corporation. If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the aquisition of the required amount of stock, or of the properties, of Corporation Y, the transaction is not a "reorganization" exchange, and the gain or loss therefrom will be recognized.

A "recapitalization," and therefore a reorganization, takes place if, for example

(1) A corporation with $200,000 par value of bonds outstanding, instead of paying them off in cash, discharges them by issuing preferred shares to the bondholders, par for par;

(2) There is surrendered to a corporation for cancellation 25 per cent of its preferred stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock; or

(4) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights.

* * * * *

The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112 (g) (1). The term is not to be construed as broadening the definition

of "reorganization" as set forth in section 112 (g) (1), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges as are directly a part of the transaction specifically described as a reorganization in that subsection. Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112 (g) (1), but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 112 (g) (1) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

* * * * * *

ART. 113 (a)-1. *Scope of basis for determining gain or loss.*—The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in section 113 (a), adjusted for the various applicable items specified in section 113 (b). Unless otherwise indicated, the word "basis," as used in this article and articles 113 (a)-2 to 113 (a) (14)-1, inclusive, has reference to the unadjusted basis.

ART. 113 (a)-2. *General rule.*—In general, the basis of property is the cost thereof. This rule is subject, however, to the exceptions stated in paragraphs (1) to (14) of section 113 (a).

* * * * * *

ART. 113 (b)-1. *Adjusted basis: General rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, is the cost of such

property or, in the case of such property as is described in paragraphs (1) to (14), inclusive, of section 113 (a), the basis therein provided, adjusted to the extent provided in section 113 (b).

* * * * * *

ART. 114–1. *Basis for allowance of depreciation and depletion.*—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in article 23 (m)–3, relating to depletion based on discovery value, in article 23 (m)–4, relating to percentage depletion in the case of oil and gas wells, and in article 23 (m)–5, relating to percentage depletion in the case of coal mines, metal mines, and sulphur mines or deposits.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BRIEF FOR THE RESPONDENT IN OPPOSITION

Opinions Below

The memorandum opinion of the United States Board of Tax Appeals (R. 31-45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63-67) is reported in 119 F. (2d) 561.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered April 19, 1941 (R. 67). The petition for a writ of certiorari was filed July 19, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

The question presented, as raised by Petitioner's Specification of Errors (Petition, p. 5), is whether the basis of certain assets in the hands of Respondent, the taxpayer, was the figure at which they were bid in at foreclosure and receivership sales by a bondholders' committee representing holders of securities of a predecessor corporation. All of the assets of the old corporation were acquired by the taxpayer, pursuant to a plan of reorganization, in exchange for stock and stock purchase warrants of the taxpayer, which were distributed to the bondholders, claimholders and stockholders of the old corporation.

Statutes Involved

These are set forth in the Appendix, *infra*, pp. 12-15.[1]

Statement[2]

The taxpayer is a Delaware corporation, organized June 27, 1934. It is the successor of Southwest Gas Utilities

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[1] The quotations from the statutes contained in the Appendix to the Commissioner's Petition (pp. 10-12) do not reflect the retroactive amendments made by the Revenue Act of 1939.

[2] The summary statement of facts contained in the Commissioner's Petition (pp. 3, 4) does not reflect a number of details considered significant.

Corporation (herein called "Utilities"). Utilities was organized in 1928, also under the laws of Delaware. (R. 31.)

The financial structure of Utilities consisted of:

171,915	shares of common stock
32,244	shares of $6.50 preferred stock
$2,871,500	First Lien and Secured Sinking Fund Gold Bonds 6½% Series
$ 126,000	Five-Year 6% Convertible Gold Notes
$ 31,945.42	Unsecured claims

(R. 33, 34, 36).

The $2,871,500 of First Lien Bonds were secured by stocks and bonds of subsidiary companies, which were pledged under an indenture (R. 32).

On May 1, 1932, Utilities defaulted in the payment of interest on its First Lien Bonds. On May 2, 1932, a bondholders' committee was organized to protect the interests of the bondholders. About 85% of the outstanding bonds were deposited with this committee. Members of the committee became directors of Utilities, and after October 7, 1932 constituted a majority of the Board. (R. 32.)

On April 10, 1933, a bill in equity was filed in the Court of Chancery in the State of Delaware by one of the bondholders, alleging insolvency of Utilities and praying for the appointment of a receiver. Utilities admitted insolvency in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Two receivers were appointed. (R. 32.)

On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization," under which participating security holders of Utilities would receive common stock and warrants to purchase common stock of a new corporation (the taxpayer) to be formed to take over the assets of Utilities. The new corporation was to have only common stock outstanding. The terms of exchange were:

Bondholders to receive 20 shares of common stock of the new company for each $1,000 principal amount.

Note and Unsecured Claim Holders to receive 2 shares of common stock and 20 Class "A" warrants for each $1,000 principal amount.

Preferred Stockholders to receive 1 Class "B" warrant for each share held.

Common Stockholders to receive 1 Class "B" warrant for each 50 shares held.[3] (R. 33, 34.)

A Class "A" warrant was the right to buy one share of common stock of the new company at $6.00 a share during 1934 and at an increased price of $1.00 per share for each year thereafter up to and including 1938. A Class "B" warrant was the right to buy one share of common stock of the new company at $10.00 a share during 1934 and at an increased price of $5.00 per share for each succeeding year up to and including 1938. (R. 33, 34.)

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against Utilities, and on May 11, 1934 the Chancellor issued a decree approving the Plan of Reorganization. Pursuant to the Plan of Reorganization, and by order of the Chancery Court, the assets pledged as security for the bonds of Utilities were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the committee for $660,000. The unpledged assets of Utilities were bid in by the committee at public auction on June 18, 1934 for $92,000. The sales were confirmed by the Chancery Court. (R. 34.)

The taxpayer was organized on June 27, 1934 (R. 31). Pursuant to the Plan of Reorganization, all of Utilities'

---

[3] It will be noted that under the Plan every type of interest in the old company had a continuing interest in the new company.

assets were transferred to the taxpayer upon its organization (R. 38) and the common stock and "A" and "B" warrants of the taxpayer were issued in exchange for bonds, notes, claims and stock of Utilities' as follows:

curity	Total Amount	Amount Participating in Plan	SOUTHWEST CONSOLIDATED Securities Issued in Exchange Pursuant to Plan		
			Common Stock	A Warrants	B Warrants
nds	$2,871,500.00	$2,450,500.00	49,010		
tes	126,000.00	107,000.00	214	2,140	
her Unsecured Claims	31,945.42	31,945.42	62	620	
ferred stock	32,244 sh.	17,297 sh.			17,297
mmon Stock	171,915 sh.	57,470 sh.			1,148 7/50
			49,286	2,760	18,445 7/50

(R. 36).

Non-participating security holders of Utilities Company received a pro rata distribution in cash (R. 37).

Holders of $871,500 principal amount of bonds and $65,000 of notes of Utilities participating in the Plan of Reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes, these security holders received 17,560 shares of common stock and 1300 Class "A" warrants of the taxpayer. With respect to their holdings of common and preferred stock of Utilities these individuals received 3,132 Class "B" warrants. (R. 37.)

Giving effect to this situation, the following table shows total distribution of common stock and warrants to purchase common stock of the taxpayer to former stockholders of Utilities and to non-stockholders:

Class of security of Southwest Consolidated	Total issued by Southwest Consolidated	Issued to stockholders of Utilities	Issued to nonstockholders of Utilities
Common	49,286	17,560	31,726
Class "A" Warrants	2,760	1,300	1,460
Class "B" Warrants	18,445 7/50	18,445 7/50	—
Total	70,491 7/50	37,305 7/50	33,186

(R. 38).

Of the 2,760 Class "A" warrants issued by the taxpayer 1,760 were exercised, and of the 18,445-7/50 Class "B" warrants issued 4,623 were exercised, before they expired in 1938 (R. 38).

The cost to Utilities for the assets transferred to the taxpayer as of June 27, 1934 was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98.[1] (R. 38.)

The taxpayer filed its first income and excess profits tax return for the period June 27, 1934 to December 31, 1934, in which it reported a net loss of $48,307.10 (R. 38). In calculating this loss the taxpayer considered its cost for the assets taken over from its predecessor was the same as the cost to its predecessor (R. 39). The taxpayer's Federal income and excess profits tax return for 1935 also showed a net loss, which was similarly computed (R. 39).

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[1] On the basis of such value of assets of the taxpayer its Class "A" warrants when issued had an indicated value of about $29 per warrant and its Class "B" warrants had an indicated value of about $25 per warrant, viz: The taxpayer issued 49,286 shares of common stock. The assets behind the stock had a value of $1,766,694.98. Such value of assets would give a value per share of about $35. A Class "A" warrant was the right to buy one share for $6. and a Class "B" warrant was the right to buy one share for $10. Thus, a Class "A" warrant-holder could get about $35 of value for $6 (a difference of $29), and a Class "B" warrant-holder could get about $35 of value for $10 (a difference of $25).

In asserting the taxes in dispute the Commissioner claimed the cost of the total assets was the amount bid at the foreclosure sales (despite the fact the fair market value of such assets was admittedly far in excess of such bid prices). He then spread the aggregate purchase prices over the respective assets on the basis of their relative values (R. 25, 26). By so doing the Commissioner arrived at lower cost bases for the assets involved in the years in question than had been used by the taxpayer in filing its returns, and in this manner he arrived at net incomes for those years, with resulting taxes as asserted (R. 39).

The Board of Tax Appeals rejected the Commissioner's contention and decided there was no deficiency for either year (R. 46). The Circuit Court affirmed (R. 67).

Argument

1. This is not an appropriate case for consideration by the Supreme Court because it involves special and peculiar facts different from the facts of any of the pending cases alleged by the Government to raise like questions. The Government seeks clarification of the law on the question of the basis of property where the creditors of an old corporation become the *sole* stockholders of a new corporation, and the stockholders of the old corporation have no continuing interest. *That question is not raised here,*

In the present case under the terms of the Plan of Reorganization every type of interest in the old corporation, including the preferred and common stockholders, had a continuing interest in the new corporation. Based on the fair market value of the underlying assets, the "B" warrants issued to the stockholders of the old corporation

had an indicated value of $25.00 per warrant (See footnote 4, p. 6). Of these warrants 4,623 were exercised (R. 38).[5]

Thus, under the terms of the Plan, the common and preferred stockholders of the old corporation *qua* stockholders retained a continuing stock interest in the new corporation and became holders of a substantial amount of its stock.[6]

Furthermore, holders of about one-third of the bonds and more than one-half of the notes of the old corporation also held large blocks of preferred and common stock of the old corporation (R. 37, 38). As a consequence, *individuals who were stockholders of the old corporation actually received under the Plan shares of stock and stock purchase warrants amounting to more than 50% of the total number issued* (R. 38).

We submit there is no good reason for granting certiorari in a case involving these special and peculiar facts.

2. On the transaction in question the Commissioner has taken inconsistent positions. As to the new corporation,

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[5] The issuance of these warrants does not, as the Government contends (Petition, p. 9), take the transaction out of the "reorganization" definition of Section 112 (g) (1) (B). The warrants constituted *an interest in* voting stock. In a sense, they represented fractions of shares of voting stock since they entitled the holder to acquire a share of stock for less than its value. A distribution of such warrants has been characterized by this Court as "essentially analogous to a stock dividend." *Miles* v. *Safe Deposit & Trust Company*, 259 U. S. 247, 252.

[6] It is unimportant that it was a minority interest. In *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378, and *G. & K. Manufacturing Co.* v. *Helvering*, 296 U. S. 389, transfers for cash and minority stock interests in the transferees were held to be "reorganizations," and in *Nelson Co.* v. *Helvering*, 296 U. S. 375, a transfer for cash and non-voting preferred stock was held to be a "reorganization."

he has claimed that there was no "reorganization." As to the holders of the securities of the old corporation, he has claimed there *was* a "reorganization," and consequently that they realized no deductible loss on the exchange of their old securities for the stock and warrants of the new corporation.[7] Section 112 (b) (3). As to the new corporation both the Board and the Circuit Court have held there was a "reorganization." As to the security holders of the old corporation, so far as known, all of them have accepted the Commissioner's claim that there was a "reorganization," and all of their cases for 1934, the year of the reorganization, have been closed on that basis; that is, without allowing them any losses.[8]

As the matter now stands all interested parties have been treated alike. It should stop there. No proper purpose is to be served by Supreme Court review of a case, involving special and peculiar facts, when any outcome different from that reached by the Board and the Circuit Court would create an inconsistent result unduly prejudicial to the interested taxpayers.

3. As stated in its Petition (p. 5), the Government is pressing this case because of the decisions in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527. These cases were very little different from *Pinellas Ice Company* v. *Commissioner*, 287 U. S. 462. In the *Pinellas* case the consideration issued by the acquiring corporation was cash and short term notes: in the *LeTulle* case the consideration was cash and secured bonds: in the *Tyng* case it was cash and long term debentures. In all three cases this Court held there was a sale and not a "reorganization."

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[7] See Board of Tax Appeals proceedings of *George Belchic* and *Mrs. Alfrey Mitchell Belchic*, B. T. A. Docket Nos. 94810, 94809.

[8] If the Commissioner has any information to the contrary, we trust he will so advise the Court.

The *Pinellas* case was decided in 1933. In 1937 the Seventh Circuit decided *Commissioner* v. *Kitselman*, 89 F. (2) 458. There the *Commissioner* claimed that a transaction somewhat similar to the one here (although there the old stockholders received no interest in the new corporation) was a "reorganization." The Circuit Court upheld the Commissioner. The taxpayer petitioned for certiorari. The Government, through the Honorable Stanley F. Reed, Solicitor General, opposed the petition,[9] *and it was denied* (302 U. S. 709).

We submit, for the same reason the *Pinellas* case afforded no reason for the Supreme Court to grant, at the instance of the taxpayer, the petition in the *Kitselman* case, the *LeTulle* and *Tyng* cases afford no reason here.

The fact is the present case is totally unlike the *LeTulle* and *Tyng* cases. In each of those cases a corporation transferred its assets to another *which was owned by different interests*. The question was whether there was a sufficient continuing interest to make the transaction a "reorganization." Here there was in substance merely a recapitalization of a continuing business enterprise. Because of financial difficulties, the bondholders agreed to exchange their bonds for stock, the note and unsecured claim holders agreed to exchange their claims for stock and warrants, and the preferred and common stockholders agreed to exchange their stock for valuable warrants to purchase stock. In substance, the situation is practically the same as if no new corporation had been formed and, instead, the old corporation had been continued in existence with a new financial structure. The Commissioner contends that in the lat-

[9] See in that case the Brief for the Respondent in Opposition, pp. 12, 13.

ter case there is a non-taxable reorganization.[1] We submit he is inconsistent to claim otherwise here.

For these reasons the *LeTulle* and *Tyng* decisions clearly do not justify certiorari.

Conclusion

The petition should be denied.

Respectfully submitted,

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August 1941.

[1] *The Hoagland Corporation* v. *Helvering*, (C. C. A. 2) decided July 24, 1941, not yet reported.

Appendix

Revenue Act of 1934, c. 277, 48 Stat. 680, as amended by Revenue Act of 1939, c. 247, 53 Stat. 862:

Sec. 112. Recognition of Gain or Loss.

(*a*) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) • • •

(*3*) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(*4*) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(*5*) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under section 213 of the Revenue

Act of 1939 it is not considered as "other property or money") shall be considered as stock or securities received by such transferor. If, as the result of a determination of the tax liability of the taxpayer for the taxable year in which the exchange occurred, by a decision of the Board of Tax Appeals or of a court which became final before the ninetieth day after the date of the enactment of the Revenue Act of 1939, or by a closing agreement, the treatment of the amount of such liability was different from the treatment which would result from the application of the preceding sentence, such sentence shall not apply and the result of such determination shall be deemed proper.

* * * * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded; or the acquisition by one corporation in exchange solely for all or a part of its voting stock of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(6) *Tax-free Exchanges Generally.*—If the property was acquired after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

BRIEF FOR THE RESPONDENT

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Attorneys for Respondent.

Post Printing Company, Inc., 80 Lafayette Street, New York, N. Y.

terests. The question was whether the transfer was more like a sale for cash, as in *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462, or more like a blending of two corporations into one, as in *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378; *G. & K. Manufacturing Company* v. *Helvering*, 296 U. S. 389; and *Nelson Co.* v. *Helvering*, 296 U. S. 375. The Court concluded the transactions in the *LeTulle* and *Tyng* cases should be treated as the equivalent of sales for cash since the consideration received was promises to to pay cash. Obviously, an entirely different question is presented here.

A. The question has been decided favorably to the taxpayer in a line of decisions extending over a long period of years, and the law so established should not be changed except by legislative action.

The basic question is whether the transaction was a "reorganization" within the non-taxable reorganization provisions of the Federal Revenue Law. These provisions have been in effect in substantially the same form for over twenty years.[3] The same question arises in determining gain or loss of the security holders of the old company (Sec. 112 (b) (3)).

By ruling issued in 1924 the *Commissioner* took the position that this kind of a transaction *was* a "reorganization" under the 1921 Act, and that therefore the bondholders of the old corporation realized no deductible loss (I. T. 2071, III-2 C. B. 34). Taxpayers disputed this but the Commissioner was upheld in every case, and this Court refused to review the question on the taxpayer's application. *De Blois, et al.* v. *Commissioner*, (C. C. A. 1) 36 F.

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[3] Beginning with the Revenue Act of 1921, Sec. 202 (c) (2); c. 136, 42 Stat. 227, 230.

(2) 11 (1929); *First National Bank of Champlain*, 21 B. T. A. 415 (1930); *Rockford Dairy, Inc.*, 26 B. T. A. 501 (1932); *Commissioner* v. *Kitselman*, (C. C. A. 7) 89 F. (2) 458 (1937), certiorari denied, 302 U. S. 709; and see also *C. H. Mead Coal Co.* v. *Commissioner*, (C. C. A. 4) 72 F. (2) 22 (1934).[1]

From the time of the promulgation of I. T. 2071, *supra*, to date, the Federal Revenue Law has undergone more or less general revision no less than thirteen times.[2] Not once has Congress indicated a desire to change the law established by these decisions.[3]

The result has been that countless holders of securities in numerous corporations which were reorganized during the '30s have been allowed no deductible losses on the exchange of their old securities for new securities. It would

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[1] In *Commissioner* v. *Newberry Lumber Co.*, (C. C. A. 6) 94 F. (2) 447 (1938), the Commissioner took the opposite position. He was unsuccessful in the Circuit Court and, Supreme Court review having been refused in the *Kitselman* case, the Commissioner did not seek certiorari.

[2] Revenue Acts of 1924, 1926, 1928, 1932, 1934, 1935, 1936, 1937, 1938, 1939, 1940, Second 1940, 1941.

[3] The Commissioner refers to the Ways & Means Committee Report on proposed changes in the reorganization provisions by the Revenue Act of 1934 (Brief, pp. 29, 30). This report not only contains nothing indicating an intention to exclude a transaction such as that here from the reorganization provisions, but, on the contrary, there are indications in the Committee Reports on the 1934 Revenue Act that it was the intention *to keep insolvency reorganizations within the statute*, for fear bondholders would be entitled to deduct their losses upon exchanges made pursuant to such reorganizations. S. Rep. No. 558, 73d Cong., 2d Sess., p. 17; H. Rep. No. 704, p. 14. The Commissioner sought and obtained his decision in the *Kitselman* case three years after the 1934 Revenue Act was passed.

be an unusual situation where the case of such a taxpayer is still unclosed.

Under these circumstances it should require the most compelling reasons at this late date to reach the conclusion that a transaction of this kind is not a "reorganization" within the meaning of the statute. By its long continued failure to amend the law in the face of the decisions on the question favoring the Commissioner, it is to be assumed Congress approved those decisions. *District of Columbia* v. *Murphy*, decided December 15, 1941;[4] *United States* v. *Stroop*, (C. C. A. 6) 109 F. (2) 891, 893, 894. We respectfully submit contrary judicial decision now would smack of legislation (cf. *Scaife Co.* v. *Commissioner*, decided December 22, 1941). It would run counter to a long period of administrative practice inaugurated by I. T. 2071, *supra*.[5] If a change in the law as heretofore interpreted is deemed desirable Congress can easily make the change.

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[4] Wherein the Court said: "A contrary decision would * * * fail to give proper weight to the trend of judicial decisions, with which Congress should be taken to have been cognizant * * * ."

[5] Cf. *United States* v. *Hendler*, 303 U. S. 564, which was contrary to long continued administrative practice and which was nullified by the Revenue Act of 1939, Section 213, c. 247, 53 Stat. 862. Even the decision itself was set aside by Sec. 910 of the Social Security Tax Amendments of 1939, c. 666, 53 Stat. Part 2, p. 1402.

B. The foreclosure and receivership sales should not be recognized as transactions having income tax effect.

The Commissioner urges the Court to recognize the nominal purchases of assets by the bondholders' committee, acting as a reorganization committee, at the foreclosure and receivership sales as independent and closed transactions, with tax consequences accordingly.

This clearly is not a proper analysis of the matter for tax purposes. The bondholders' committee was merely the instrumentality through which the assets of Utilities were transferred to the taxpayer in exchange for its stock and warrants. What happened was all pursuant to a single plan of reorganization, approved by the court as such before the first step was taken. There is no principle more firmly established in the tax law than that in matters of this kind taxes are to be determined on the basis of what was ultimately accomplished, and separate tax effect will not be given to various conditional intermediate steps.[6]

The Circuit Court here was plainly right in concluding:

> "In effect, the committee was the agent of the old company in the transfer of the assets. When they bid them in at public auction they held them as trustee

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[6] Decisions of *all* of the Federal Circuit Courts of Appeals can be cited to this effect, including, among numerous others, *Portland Oil Company* v. *Commissioner*, (C. C. A. 1) 109 F. (2) 479; *Ahles Realty Corporation* v. *Commissioner*, (C. C. A. 2) 71 F. (2) 150; *Diescher* v. *Commissioner*, (C. C. A. 3) 110 F. (2) 90; *Helvering* v. *Elkhorn Coal Company*, (C. C. A. 4) 95 F. (2) 732; *Kuddell* v. *Commissioner*, (C. C. A. 5) 97 F. (2) 725; *Snowden* v. *McCabe*, (C. C. A. 6) 111 F. (2) 743; *Commissioner* v. *Kitselman*, (C. C. A. 7) *supra*; *Anheuser-Busch, Inc.* v. *Helvering*, (C. C. A. 8) 115 F. (2) 662; *Commissioner* v. *Schumacher Wall Board Corporation*, (C. C. A. 9) 93 F. (2) 79; *Prairie Oil & Gas Company* v. *Motter*, (C. C. A. 10) 66 F. (2) 309.

> for the new company. In principle and in substantial results the transfer was the same as if it were direct from the old company." (R. 66, 67.)[7]

The Second Circuit in the case of *Helvering* v. *New Haven & S. L. R. Co.*, 121 F. (2) 985, 988, No. 780, this Term, disposed of this contention by saying:

> "As for the effort of the Commissioner to atomize the plan, as it were, i.e. to separate it into several steps and treat the last as though it stood alone, it has been repeatedly repudiated." (Citing cases.)

In *Kansas City Railway Company* v. *Guardian Trust Company*, 240 U. S. 166, 176, 177, this Court recognized that a proceeding such as that here should be regarded "as one from the start to the close." See also 15 Fletcher on Corporations, Secs. 7270, 7271.

If the Court should disregard this well established principle in deciding the present case it is safe to say the resulting confusion in the administration of the tax law would be tremendous.

It is therefore submitted the present case should be decided by considering that, for tax purposes, what happened was a transfer of all of the assets of Utilities by it to the taxpayer in exchange for stock and warrants, which were distributed to the security holders and stockholders of Utilities as their interests then appeared. The question is whether, thus considered, the transaction constituted a "reorganization" within the definitions of Section 112 (g), with resulting applicability of Section 113 (a) (7).

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[7] It will be noted that the Fifth Circuit distinguished this case from *Commissioner* v. *Bondholders' Committee*, *Marlborough Investment Co.*, (C. C. A. 9) 118 F. (2) 511, Nos. 128, 1929 this Term, on the ground that there there was an independent unconditional foreclosure. (R. 66.)

C. The transaction here was a "reorganization" under Section 112 (g) (1), and basis of the taxpayer is basis of its predecessor under Section 113 (a) (7).

Section 112 (g) (1) defines "reorganization" as including five types of transactions. It is sufficient if the transaction here qualifies under any one of these. We submit it qualifies under all of them except Clauses A and C.

1. Clause B applies because the taxpayer acquired all of the assets of Utilities "in exchange solely for all or a part of its voting stock." In determining whether the exchange is solely for voting stock the assumption of a liability is disregarded.[8] Respondent claims Clause B does not apply, arguing the exchange was not "solely" for voting stock but "by hypothesis, cash for dissenters and the stock purchase warrants were also exchanged" (Brief, p. 21).

As to the cash, used "to buy out the interests of non-assenters" to the plan (Commissioner's Brief, p. 21), the Board found that this cash and cash to meet expenses was obtained by loan from a bank "which loan was assumed by the petitioner (taxpayer) and was later repaid by it" (R. 37). Therefore, under the amendment of Sec. 112 (g) (1) by the Revenue Act of 1939 the assumption of this obligation, or the taking of the property subject to this liability, is to be disregarded in determining whether the exchange was "solely" for stock.[9]

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[8] See Revenue Act of 1939, Sec. 213 (g) (1) and (2), c. 247, 53 Stat. 862, which amended retroactively Sec. 112 (g) (1) of the Revenue Act of 1934, the applicable statute.

[9] Respondent apparently has overlooked this retroactive amendment of Sec. 112 (g) (1) since his quotation of the statute does not reflect it (Brief, p. 33).

As to the warrants, the Commissioner claims, on the one hand, they are to be disregarded in determining whether the stockholders of the old corporation had a continuing interest in the taxpayer, and, on the other hand, that they are to be recognized in order to make inapplicable Clause B. If the warrants are to be disregarded for one purpose, we submit they should be disregarded for both purposes.[1] Giving full recognition to the warrants, however, does not make inapplicable Clause B, as the Commissioner claims. The warrants constituted *an interest in* voting stock. In a sense, they represented fractions of shares of voting stock, since they entitled the holder to acquire a share of stock for less than its value.[2] A distribution of such warrants has been characterized by this court as "essentially analogous to a stock dividend." *Miles* v. *Safe Deposit & Trust Company*, 259 U. S. 247, 252. It would be an unreasonable interpretation of the statute to say that a transaction otherwise qualifying as a "reorganization" under Clause B was not such simply because part of the consideration consisted of an interest in voting stock represented by stock purchase warrants.[3]

2. Clause D applies because, in substance, the transaction here was merely a "recapitalization" of a corporate

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[1] The Circuit Court apparently considered they should be disregarded (R. 65).

[2] See fn. 6, p. 6.

[3] While the Commissioner now repudiates it (Brief, p. 22; fn. 12), in an unpublished ruling in 1937 he expressed, what would seem to be the reasonable view, that the presence of such warrants does not remove the transaction from within the intent of a reorganization as defined in Clause B (1937 C. C. H., Vol. 3, Par. 6118; 1937 Prentice-Hall, Vol. I, Par. 501.)

business. The bondholders and other claim-holders exchanged their bonds for stock, and the stockholders exchanged their stock for valuable warrants to purchase stock. If the same result had been reached by continuing the old corporation in existence, there would have been a "recapitalization" and hence a "reorganization" without question, and the Commissioner presumably would so contend (*The Hoagland Corporation* v. *Helvering*, (C. C. A. 2) 121 F. (2) 962). Since in tax matters substance and not form controls, we submit the mere fact of the organization of a new corporate entity should not affect the result here. Both corporations were incorporated in Delaware (R. 31); both had the same assets; there was no new or different interest in the new corporate entity. It is therefore submitted that, giving the word "recapitalization" its commonly accepted meaning,[1] this transaction qualifies as such.

3. Clause E applies because there was "a mere change in identity, form or place of organization" of the business. The facts speak for themselves. The business enterprise continued unchanged. All those who had an interest in the old company were given an opportunity to continue in the new company on a basis which the court that approved the plan of reorganization considered fairly reflected their existing interests in the enterprise.

Since the transaction was a "reorganization" within the meaning of the statute, under Sec. 113 (a) (7) the basis of

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[1] See Cook on Corporations, 8th Ed., Vol. 5, Sec. 883, p. 4103.

the taxpayer is the same as it would be in the hands of Utilities, because an "interest or control" of 50% or more remained in the same persons. The statute is in the disjunctive,—interest *or* control. Either is sufficient. Both existed here. As to interest, not 50% but 100% remained in the same persons since there was no new or different interest in the transferee corporation. Furthermore, as above noted, presumably there was no change in relative interest. As to control, before the reorganization the bondholders held it as a practical matter, as evidenced by the fact that members of the bondholders' committee became directors of Utilities and constituted a majority of the board (R. 32). After the reorganization, the bondholders were the majority stockholders.

It is therefore submitted the transaction here constituted a "reorganization" under Sec. 112 (g) (1) and basis is the same as in the hands of the transferor under Sec. 113 (a) (7). The Commissioner claims this is inconsistent with the principles underlying the decisions in *LeTulle* v. *Scofield, supra,* and *Helvering* v. *Tyng, supra,* and that such a result would be unreasonable. These considerations do not justify this Court in ignoring the terms of the statute.[5] Furthermore, as indicated below, the Commissioner's contentions in these respects are unfounded.

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[5] Cf. *Groman* v. *Commissioner*, 302 U. S. 82; *Helvering* v. *Bashford*, 302 U. S. 454, where the Court adhered strictly to the letter of the reorganization provisions, although broader principles indicated a different result.

D. The LeTulle and Tyng cases are not in point and other decisions of this Court are in accord with the decision below.

At the outset it was indicated why, broadly, the *Le Tulle* and *Tyng* cases are not relevant (see pp. 9, 10, *supra*). They hold that a promise to pay cash is the equivalent of cash in determining whether a transaction is a sale or a "reorganization," whereas a different problem is presented here.[6]

Those cases were very little different from *Pinellas Ice Company* v. *Commissioner*, 287 U. S. 462. In all three cases the acquiring corporations were owned by interests different from the interests in the selling corporations. In the *Pinellas* case the consideration paid by the acquiring corporation was cash and short term notes: in the *LeTulle* case the consideration was cash and secured bonds: in the *Tyng* case it was cash and long term debentures. In each case the Court held the transaction was more akin to a sale than to a "reorganization". We submit that, for present purposes, the three cases are indistinguishable.

The *Pinellas* case was decided in 1933. Thereafter in pressing for the decision in the *Kitselman* case and claiming that the transaction there was a "reorganization" (although, unlike this case, the old stockholders there received no interest in the new corporation), the Commissioner found no difficulty in the *Pinellas* case, and the Seventh Circuit in reaching its conclusion did not consider the *Pinellas* case relevant. The taxpayer petitioned for certiorari: The Commissioner opposed,[7] and this Court denied the petition (302 U. S. 709), thereby apparently finding no conflict between that decision and the *Pinellas*

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[6] See Paul, Studies in Federal Taxation, Third Series, p. 160, fn. 468.

[7] See in that case the Brief for the Respondent in Opposition, pp. 12, 13.

case.[8] We submit, correspondingly, there is no conflict here with the *LeTulle* and *Tyng* cases.

The Commissioner invokes those decisions on the assumption that here there was no continuing stockholder interest. The fact is there was a continuing interest of stockholders of the old company. They were recognized under the plan by the issuance to them of valuable warrants to purchase stock (fn. 6, p. 6, *supra*). A substantial number of these warrants were exercised (R. 38). Furthermore, holders of about one-third of its bonds and more than one-half of its notes also held large amounts of preferred and common stock of the old company (R. 37, 38). As a consequence, *persons who were stockholders of the old company actually received under the plan shares of stock and warrants to purchase stock carrying potential voting control of the new company* (R. 38). The Commissioner urges the Court to disregard this circumstance as being without significance (Brief, p. 23, fn. 13). We submit it is a relevant fact that cannot be disregarded. It amply fulfills any possible requirement for a continuing interest on the part of the old stockholders. There is nothing in the statute warranting disregard of this factual situation.

Furthermore, in view of these facts the decision of the Circuit Court here is supported by a number of decisions of this Court. In *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378, and in *G. & K. Manufacturing Company* v. *Helvering*, 296 U. S. 389, transfers for cash and minority stock interests[9] were held to be non-taxable "reorganizations"; and in *Nelson Co.* v. *Helvering*, 296 U. S. 375, a

[8] If the Court had considered there was such a conflict, presumably it would have granted the petition. Supreme Court Rule 35, Par. 5 (b).

[9] In the *Minnesota Tea* case the stock interest acquired was less than 8%. (See 28 B. T. A. 591, 592.) In the present case the stock issued on exercise of the "B" warrants alone constituted over 8% of all of the stock of the taxpayer (R. 36, 38).

transfer for cash and non-voting preferred stock was held to be a "reorganization." Such cases are by no means so clear as the present case because there one corporation was being acquired by another in which there were wholly different interests, whereas here there was in substance merely a recapitalization of a single continuing business enterprise.

E. Practical aspects of the problem do not call for a reversal of the Circuit Court's decision.

The Commissioner argues that it is unreasonable to permit the new corporation to use the basis of the old, claiming this would result in "an obvious tax windfall" (Brief, p. 13).

It leads nowhere to argue as to the reasonableness of corporate taxes. While a corporation is a fiction, nevertheless, it is recognized as a taxable person. As a result, income is taxed once to the corporation and again when it is distributed to the stockholders.[1] It might well be claimed that this double taxation itself is unreasonable. Yet, there is no possible basis for defeating it by judicial interpretation.

The present case concerns the tax of a corporation. The investment of its stockholders is a wholly immaterial consideration under our scheme of taxation. There is no call upon the courts to bring about a synthesis by judicial interpretation, and there is certainly no warrant for so doing when, as here, it would run counter to the terms of the statute.

Furthermore, we submit, more can be said for the reasonableness and equity of the taxpayer's position than can

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[1] The slight relief formerly accorded by exempting corporate dividends from normal individual tax (1934 Act, Sec. 25 (a) (1)) was abandoned beginning with the Revenue Act of 1936 (Cf. Sec. 25).

be said for that of the Commissioner. The corporate basis of the assets of Utilities as they existed at the time of the reorganization was $8,995,724.91. The Commissioner would reduce this basis to $1,766,694.98. Under the Commissioner's contention the difference of over $7,000,000 in corporate basis would evaporate, despite the fact that the same business enterprise continued unchanged and, to a large extent, the same persons continued to be interested in it. The result would be corporate taxation of fictitious corporate profits, and the consequences would be far more unreasonable than under the Circuit Court's decision.

Finally, if there is anything to this argument of the Commissioner, we submit the corrective is legislation and not judicial interpretation (Cf. *Scaife Co.* v. *Commissioner*, and *Helvering* v. *Lerner Stores Corporation*, decided December 22, 1941). It is not practicable for courts to try to shape tax laws in the light of such dubious and illusory considerations. What might seem reasonable to one, might seem unreasonable to another. A decision which might seem to produce a reasonable result in one case might establish a principle that would produce a wholly unreasonable result in another case. That way lies chaos in tax administration.

Conclusion

The judgment of the Circuit Court should be affirmed.

Respectfully submitted,

A. Chauncey Newlin,
Fred Simon,
Attorneys for Respondent.

January 1942.

Appendix

Revenue Act of 1934, c. 277, 48 Stat. 680, as amended by Revenue Act of 1939, c. 247, 53 Stat. 862:

Sec. 112. Recognition of Gain or Loss.

(*a*) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) * * *.

(*3*) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(*g*) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded; or the acquisition by one corporation in exchange solely for all or a part of its voting stock of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form or place of organization, however effected.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

Opinions Below

The memorandum opinion of the United States Board of Tax Appeals (R. 31-45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63-67) is reported in 119 F. (2d) 561.

Question Presented

Pursuant to a "plan of reorganization," approved by the Delaware Chancery Court in an equity receivership proceeding, the respondent taxpayer acquired all of the assets of a predecessor corporation in exchange for all of the

common stock of the taxpayer, which was distributed to participating creditors, and warrants to purchase such stock, which were distributed in part to creditors and in part to former stockholders. The question is the taxpayer's basis for the assets so acquired.

Petitioner's Specification of Errors asserted that basis to the taxpayer was "cost to the bondholders' committee at the foreclosure and receivership sales," and was not cost to the old company (Petition for Certiorari, p. 5). On Brief the Commissioner, abandoning his previous position, now concedes that basis is not the bid price at the foreclosure and receivership sales,[1] but claims it is the fair market value of the property at that time[2] (Brief, p. 13, fn. 5; and see "Conclusion," pp. 30, 31). Therefore, the question now is whether basis is cost to the old company or fair market value at the time of the reorganization.

Statutes Involved

These are set forth in the Appendix, *infra*, pp. 23, 24.[3]

Statement[4]

The taxpayer is a Delaware corporation, organized June 27, 1934. It is the successor of Southwest Gas Utilities Cor-

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[1] $752,000 (R. 34).

[2] $1,766,694.98 (R. 38).

[3] The quotations from the statutes contained in the Appendix to the Commissioner's Brief (pp. 32-35) do not reflect the retroactive amendments made by the Revenue Act of 1939, c. 247, 53 Stat. 862. These amendments have significance here (see p. 15, *infra*).

[4] The summary statement of facts contained in the Commissioner's Brief (pp. 2-5) does not reflect a number of details considered significant.

poration (herein called "Utilities"). Utilities was organized in 1928, also under the laws of Delaware (R. 31).

The financial structure of Utilities consisted of:

171,915	shares of common stock
32,244	shares of $6.50 preferred stock
$2,871,500	First Lien and Secured Sinking Fund Gold Bonds 6½% Series
$ 126,000	Five-Year 6% Convertible Gold Notes
$ 31,945.42	Unsecured claims

(R. 33, 34, 36).

The $2,871,500 of First Lien Bonds were secured by stocks and bonds of subsidiary companies, which were pledged under an indenture (R. 32).

On May 1, 1932, Utilities defaulted in the payment of interest on its First Lien Bonds. On May 2, 1932 a bondholders' committee was organized to protect the interests of the bondholders. About 85% of the outstanding bonds were deposited with this committee. Members of the committee became directors of Utilities, and after October 7, 1932 constituted a majority of the Board. (R. 32.)

On April 10, 1933, a bill in equity was filed in the Court of Chancery in the State of Delaware by one of the bondholders, alleging insolvency of Utilities and praying for the appointment of a receiver. Utilities admitted insolvency in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Two receivers were appointed. (R. 32.)

On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization," under which participating security holders of Utilities would receive common stock and warrants to purchase common stock of a new corporation (the taxpayer) to be formed to take over the assets of Utilities. The new corporation was to have only common stock outstanding. The terms of exchange were:

Bondholders to receive 20 shares of common stock of the new company for each $1,000 principal amount.

Note and Unsecured Claim Holders to receive 2 shares of common stock and 20 Class "A" warrants for each $1,000 principal amount.

Preferred Stockholders to receive 1 Class "B" warrant for each share held.

Common Stockholders to receive 1 Class "B" warrant for each 50 shares held.[5] (R. 33, 34.)

A Class "A" warrant was the right to buy one share of common stock of the new company at $6.00 a share during 1934 and at an increased price of $1.00 per share for each year thereafter up to and including 1938. A Class "B" warrant was the right to buy one share of common stock of the new company at $10.00 a share during 1934 and at an increased price of $5.00 per share for each succeeding year up to and including 1938. (R. 33, 34.)

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against Utilities, and on May 11, 1934 the Chancellor issued a decree approving the Plan of Reorganization. Pursuant to the Plan of Reorganization and by order of the Chancery Court, the assets pledged as security for the bonds of Utilities were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the committee for $660,000. The unpledged assets of Utilities were bid in by the committee at public auction on June 18, 1934 for $92,000. The sales were confirmed by the Chancery Court. (R. 34.)

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[5] It will be noted that under the Plan every type of interest in the old company had a continuing interest in the new company.

The taxpayer was organized on June 27, 1934 (R. 31). Pursuant to the Plan of Reorganization, all of Utilities' assets were transferred to the taxpayer upon its organization (R. 38) and the common stock and "A" and "B" warrants of the taxpayer were issued in exchange for bonds, notes, claims and stock of Utilities, as follows:

curity	Total Amount	Amount Participating in Plan	SOUTHWEST CONSOLIDATED Securities Issued in Exchange Pursuant to Plan		
			Common Stock	A Warrants	B Warrants
nds	$2,871,500.00	$2,450,500.00	49,010		
tes	126,000.00	107,000.00	214	2,140	
her Unsecured Claims	31,945.42	31,945.42	62	620	
referred Stock	32,244 sh.	17,297 sh.			17,297
mmon Stock	171,915 sh.	57,470 sh.			1,148 7/50

(R. 36).

Non-participating security holders of Utilities received $106,684.06 in cash. The cash to make this payment and to meet expenses was obtained by loan from a bank. In connection with acquiring all of the assets the taxpayer assumed the loan and later repaid it. (R. 37, 26.)

Holders of $871,500 principal amount of bonds and $65,000 of notes of Utilities participating in the Plan of Reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes, these security holders received 17,560 shares of common stock and 1300 Class "A" warrants of the taxpayer. With respect to their holdings of common and preferred stock of Utilities these individuals received 3,132 Class "B" warrants. (R. 37.)

Giving effect to this situation, the following table shows total distribution of common stock and warrants to pur-

chase common stock of the taxpayer to former stockholders of Utilities and to nonstockholders:

Class of security of Southwest Consolidated	Total issued by Southwest Consolidated	Issued to stockholders of Utilities	Issued to nonstockholders of Utilities
Common	49,286	17,560	31,726
Class "A" Warrants	2,760	1,300	1,460
Class "B" Warrants	18,445 7/50	18,445 7/50	—
Total	70,491 7/50	37,305 7/50	33,186

(R. 38).

Of the 2,760 Class "A" warrants issued by the taxpayer 1,760 were exercised, and of the 18,445–7/50 Class "B" warrants issued 4,623 were exercised, before they expired in 1938 (R. 38).

The cost to Utilities for the assets transferred to the taxpayer as of June 27, 1934 was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98.[6] (R. 38).

The taxpayer filed its first income and excess profits tax return for the period June 27, 1934 to December 31, 1934, in which it reported a net loss of $48,307.10 (R. 38). In calculating this loss the taxpayer considered its cost for the assets taken over from its predecessor was the same

[6] On the basis of such value of assets of the taxpayer its Class "A" warrants when issued had an indicated value of about $29 per warrant and its Class "B" warrants had an indicated value of about $25 per warrant, viz: The taxpayer issued 49,286 shares of common stock. The assets behind the stock had a value of $1,766,694.98. Such value of assets would give a value per share of about $35. A Class "A" warrant was the right to buy one share for $6 and a Class "B" warrant was the right to buy one share for $10. Thus, a Class "A" warrant-holder could get about $35 of value for $6 (a difference of $29) and a Class "B" warrant-holder could get about $35 of value for $10 (a difference of $25).

as the cost to its predecessor (R. 39). The taxpayer's Federal income and excess-profits tax return for 1935 also showed a net loss, which was similarly computed (R. 39).

In asserting the taxes in dispute the Commissioner claimed the cost of the total assets was the amount bid at the foreclosure sales. He then spread the aggregate purchase prices over the respective assets on the basis of their relative values (R. 25, 26). By so doing the Commissioner arrived at lower cost bases for the assets involved in the years in question than had been used by the taxpayer in filing its returns, and in this manner he arrived at net incomes for those years, with resulting taxes as asserted (R. 39).

The Board of Tax Appeals rejected the Commissioner's contention and held taxpayer's basis was cost to Utilities. This resulted in no deficiency for either year (R. 46). The Circuit Court affirmed (R. 67).

Summary of Argument

This case involves that type of reorganization where the financial structure of a single corporation is reconstituted. It does not involve that type of reorganization where the properties of two or more corporations are combined. It is thus entirely different from such cases as *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527, relied on by the Commissioner.

The question involved has been decided in a line of decisions extending over a long period of years. All of these decisions, except one, were in favor of the Commissioner. The rule of these cases requires an affirmance here. The law so established should not be changed at this late date except by legislation.

The Commissioner asks the Court to treat the transaction as having the same tax consequences as an ordinary

foreclosure. Since, however, the foreclosure and receivership sales here were merely steps in a single plan of reorganization, they should not be given tax effect. It is well settled that in matters of this kind conditional intermediate steps are disregarded. The statutory rule is applied to the net result. So considered, the transaction was a reorganization within three of the five definitions in Section 112 (g) (1), and the basis of the taxpayer is the same as the basis of its predecessor, under Section 113 (a) (7).

Under the plan, the stockholders of the old company were given valuable warrants to purchase stock in the new company. Also, holders of securities of the old company held large amounts of preferred and common stock of that company. As a consequence, persons who were stockholders of the old company actually received under the plan shares of stock and warrants to purchase stock of the new company amounting to more than 50% of the total number issued, and thus carrying potential voting control. Under these circumstances, the decision below is in accord with *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *G. & K. Manufacturing Co.* v. *Helvering*, 296 U. S. 389; *Nelson Co.* v. *Helvering*, 296 U. S. 375.

The result claimed by the taxpayer is fair and reasonable and is consistent with the Federal scheme of taxing corporate entities as such. The Commissioner's position would result in taxing fictitious corporate profits, since a large part of the basis of the old company would disappear.

ARGUMENT

The basis of the taxpayer's assets is the same as in the hands of its predecessor.

Introductory—This case involves that type of reorganization where a corporate financial structure is reconstituted (as distinguished from the case where the assets of two or more corporations are combined). Because of financial difficulties the bondholders agreed to exchange their bonds for stock[7] and the stockholders agreed to exchange their stock for valuable warrants to purchase stock.[8] The same persons who had an interest in the old company were given a continuing interest in the new company, except that after the reorganization their interests were represented by different types of securities than before. It is to be assumed their relative economic positions remained unchanged. Otherwise, the plan would have been unfair, and the plan had judicial approval. The business entity continued unchanged.

The situation is totally different from that involved in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527, relied on by the Commissioner. In each of those cases the assets of one corporation were transferred to another corporation which was owned by different in-

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[7] In so doing the bondholders did not in a realistic sense substantially change their position. They were already joint heirs in the fortunes of the business and, as a practical matter, were no less co-owners before the exchange than they were after it. Dewing, Financial Policy of Corporations, Fourth Ed., Vol. 1, pp. 169, 170; Berle and Means, The Modern Corporation and Private Property, pp. 279, 280; Graham and Dodd, Security Analysis, 2nd Ed., p. 69.

[8] See fn. 6, p. 6.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

SUPPLEMENT TO BRIEF FOR RESPONDENT

This case involves an old fashioned equity receivership proceeding (R. 32). If the plan were carried out today, in all probability the parties would proceed under Chapter X of the Bankruptcy Act.[1] The tax consequences of a Chapter X proceeding reveal recent[2] Congressional intent as to the tax consequences of insolvency reorganizations.

In his Brief (fn. 2, pp. 7, 8), the Commissioner points out that in a proceeding under Chapter X the debtor's basis, or the basis of "any person required to use the

[1] C. 575, 52 Stat. 840, as amended by c. 500, 54 Stat. 709, Sec. 1.

[2] The Chandler Act was passed in 1938 and amended in 1940.

debtor's basis," shall be decreased by[3] an amount equal to the amount by which the indebtedness of the debtor has been cancelled or reduced in the proceeding, but to an amount not less than fair market value (Sec. 270). This provision is correlative to Section 268 of Chapter X, which provides that the debtor shall not be deemed to have realized income from the reduction of its indebtedness (contrary to such decisions as *United States* v. *Kirby Lumber Company*, 284 U. S. 1).[4]

The provisions for the adjustment of basis in Chapter X are significant here since they recognize that a new corporation created under a Chapter X plan may be required to use the debtor's basis. This is contrary to the Commissioner's primary argument that in an insolvency reorganization basis should not be carried over. It confirms the argument that Congress approved the line of decisions holding an insolvency reorganization within the non-taxable reorganization and basis provisions of the Revenue Act (taxpayer's *Brief*, pp. 10-12). Such decisions as *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527, do not warrant frustration of this legislative intent.

A further guide to the proper decision here is afforded by noting the tax consequences if the present reorganization had been carried out under Chapter X. Assuming no new corporation had been formed, there would be no question as to carry over of basis. However, basis of the old company would have been reduced by an amount equal to the amount by which its indebtedness was reduced

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[3] In his Brief (fn. 2, p. 8) the Commissioner has incorrectly quoted the statute. He quotes it as "decreased to an amount" whereas it should be "decreased by an amount."

[4] H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55, 56; S. Rep. No. 1916, 75th Cong., 3rd Sess., pp. 7, 8.

(because under Section 268 the old company would not have been taxed on that amount). Where stock is given for indebtedness under a Chapter X plan, the Commissioner considers indebtedness is reduced by the difference, if any, between the fair market value of the stock and the face amount of the indebtedness on account of which the stock is received (G.C.M. 22528, 1941-8 Int. Rev. Bull. 2). In the present case the fair market value of the assets, and hence of the new securities, was $1,766,694.98 (R. 38). The face amount of indebtedness of the old company was $3,029,445.42 (R. 36). The difference is $1,262,750.44. Deducting this amount, pursuant to Section 270 of Chapter X (as interpreted by G.C.M. 22528, *supra*), from the basis of the old company of $8,995,724.91 (R. 38), gives a basis of $7,732,974.47.

If Congress by specific provision saw fit to make adjustments of this nature with such result, it seems clear there was no contemplation by Congress that insolvency reorganizations as such were to be without the non-taxable reorganization and correlative basis provisions of the Revenue Act.

Respectfully submitted,

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Attorneys for Respondent.

January 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. 286, 328.

GUY T. HELVERING, Commissioner of Internal Revenue, *Petitioner*,

v.

SOUTHWEST CONSOLIDATED CORPORATION, *Respondent*.

SAME

v.

ALABAMA ASPHALTIC LIMESTONE COMPANY.

BRIEF AMICUS CURIAE.

WALTER J. BROBYN,
EDGAR J. GOODRICH,
NEIL BURKINSHAW,
Washington, D. C.,
Amici Curiae.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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BRIEF AMICUS CURIAE.

Introductory Remarks.

Authorization to file this brief Amicus Curiae obtained from counsel for the two respondent taxpayers designated and the Solicitor General of the United States is herewith submitted with this brief and it is respectfully prayed that this Honorable Court consider this brief Amicus Curiae in connection with its deliberations in the four cases consolidated for hearing as well as in connection with its subse-

quent decisions in cases now pending action of this Court on petitions for writs of certiorari in Cement Investors, Inc., No. 644, James Q. Newton Trust and James Q. Newton, Jr., Nos. 645, 646 and New Haven & Shore Line Railway Company, No. 780.

This brief is presented as friend of the Court to support the contention of the respective taxpayers that the decisions of the 9th Circuit Court of Appeals in the cases of Marlborough House, Inc. and Palm Springs Holding Company be reversed and that the decisions of the several Circuits in the remaining cases be affirmed.

It is not the purpose here to discuss any of the facts or attempt to point out any distinctions in the facts of any of the several cases consolidated for hearing, for it is believed that despite a number of differences the fundamental question is common to all.

Reduced to its fundamentals the question is simply this:

Does a non-taxable reorganization result within the meaning of the reorganization definition contained in Section 112 of the applicable revenue acts[1] where creditors of an insolvent corporation whose claims exceed the value of the corporate assets, adopt a plan of reorganization for the sole purpose of perpetuating the business enterprise of the corporation and also their exclusive interest in the assets under a new corporate form, and in pursuance of such plan appropriate legal proceedings are instituted by a creditors' committee or other representatives of their interests by which their exclusive interests in the assets are judicially established, after which such assets are transferred to a new corporation organized for the sole purpose of acquiring such assets and of continuing the business enterprise, and upon completion of the several related steps the object of the pre-existing plan of reorganization is achieved, namely, the creditors of the old corporation who have the sole beneficial interest in the assets become the stockholders of the new corporation with that same interest preserved?

[1] See appendices to briefs of parties herein.

Background of Controversy.

The history of this type of situation and the controversies arising between taxpayers and the Bureau of Internal Revenue is illuminating. In all instances the Bureau has taken the position which will gain the most tax, on the one hand contending for a statutory reorganization when individual bondholders or other creditors seek loss deductions by reason of their holdings in the old corporation, but on the other hand where it is to the taxpayer's advantage in establishing the basis for gain or loss or for depreciation or depletion allowance, the Bureau, ignoring its previous position, contends that each step in the procedure should be considered separately and that the requisites for a statutory reorganization are not present. This latter type of controversy is now before this Court for its decision.

At the time when the instant cases were pending before the Bureau of Internal Revenue or awaiting decision of the Board of Tax Appeals the Commissioner successfully sustained his contention that a statutory reorganization resulted, in the leading case of *Commissioner* v. *Irene O. Kitselman*, 89 Fed. (2d) 458, certiorari denied, 302 U. S. 709. The importance of the Kitselman decision was the adoption of the Commissioner's own theory by the 7th Circuit Court of Appeals (while at the same time the Commissioner was contending for an opposite theory before the Board of Tax Appeals where the basis question was involved) that where a corporation is so hopelessly insolvent that its stockholders have no interest in the assets, the creditors acquire the sole proprietary interest to such assets and are in substance pretty much the corporation. It was there held that this exclusive beneficial right in the creditors could be preserved under a new corporate set-up without altering the existing equities and further that participation of the old stockholders in the new set-up was unnecessary. In fact this theory advanced by the Commissioner and approved by the court in the Kitselman case had been the long standing view of the Commissioner as evidenced by the statement in his ruling as early as 1924 (I. T. 2071, III-2 C. B. 34) that—

> "When the reorganization is through a foreclosure sale, stockholders need not be joined in the plan nor given the right to participate, and if they are given the right to participate it is purely a matter of favor."

The Commissioner further emphasized this theory in his brief in opposition to the petition for certiorari to this Court in the *Kitselman* case where he stated on page 13 thereof—

> "The only reason the stockholders would not participate in the plan was that their stock represented no assets and was valueless, and therefore they were without right to speak. See In re 620 Church Street Corporation, 299 U. S. 24, 27. While the bondholders are ordinarily viewed merely as creditors, when the assets of the corporation in receivership are less than its obligations, the bondholders are for all *practical purposes* the corporation. All that remains for the stockholders is the corporate charter."

But now in the instant cases before this Court the Commissioner advances exactly the opposite proposition, that for all *practical purposes* the bondholders or other creditors remain nothing but creditors despite the insolvency of the corporation; that they never supplant the stockholders in the equitable ownership of the insolvent's assets. This contention, we submit, ignores realities and the long and well established doctrine with respect to corporate creditors in insolvency proceedings. (See *infra*, pp. 5, 6, 7.)

ARGUMENT.

Point I.

Bondholders of An Insolvent Corporation Have a Proprietary Stake in Its Property.

This brief is directed particularly against the Commissioner's contention that this Court's decision in *Letulle* v. *Scofield*, 308 U. S. 415, in effect nullified the doctrine of the Kitselman case, (Commissioner's Principal Brief in Southwest Consolidated Corporation, No. 286) with respect to a

creditor interest on insolvency taking the place of the stockholder interest.

A close analysis of the Letulle opinion in the light of the circumstances with which it dealt, does not impel such a conclusion; that case does not hold that the required "continuity of proprietary interest" may not have its source in the beneficial interest of creditors in the assets of an insolvent corporation. The opinion was confined strictly to the facts before it and applied to those specific facts the self-evident rule that bondholders of a financially solvent corporation have no "proprietary stake" in the enterprise; they are and remain during solvency merely creditors of the corporation.

Furthermore it is to be noted that this Court was speaking of a *present* situation, when it stated that merely because a bondholder would take the assets upon default, does not change "his status from that of a creditor to one having a proprietary stake within the purview of the statute". At the time of which the Court spoke the transferee corporation was solvent and the receipt of bonds by the transferor of property conferred upon him nothing more than a creditor status. Beyond question the present creditor status in connection with the solvent transferee could not be considered a proprietary interest merely because of the possibility of default in those bonds sometime in the future, and that is the length and breadth of this Court's decision in the Letulle case. It was speaking of a present solvent situation which could not be affected by a future eventuality.

In holding that bondholders of a present solvent corporation have no proprietary interest or stake in its assets, this Court did not even intimate that bondholders of an insolvent corporation have no proprietary interest. Indeed there are very strong pronouncements of this Court establishing the well recognized rule of equity that bondholders and other creditors have the sole beneficial interest where the assets are insufficient to satisfy their claims. Thus in *Hollins* v. *Brierfield Coal Co.*, 150 U. S. 371, 383, this Court said:

> "Solvent it holds its property as an individual holds his, free from the touch of a creditor who has acquired no lien * * *".

But in the same case the Court stated:

> "Becoming insolvent * * * places the property in a condition of trust, first for the creditors and then for the stockholders."

In *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482 at p. 504, it was said:

> "The property was a trust fund charged primarily with the payment of corporate liabilities".

And in *Investment Register Ltd.* v. *Chicago M. E. Ry. Co.*, 212 Fed. 594 (C. C. A. 7th) at p. 609, where the corporation was hopelessly insolvent and its assets were insufficient to pay off the bonds in full, it was stated:

> "The property virtually belongs in equity to the bondholders".

See also *Graham* v. *La Crosse Ry.*, 102 U. S. 148, 161; *Mellen* v. *Moline Iron Works*, 131 U. S. 352; *Blake* v. *McClung*, 172 U. S. 239, 254, all recognizing the trust fund theory and the bondholders' beneficial interest to the exclusion of stockholders where insolvency occurs.

In tax cases too, this theory prevails substantially effecting tax consequences. Thus in *Commissioner* v. *Keller*, 59 Fed. (2d) 50[illegible], a radical difference appears dependent upon solvency and insolvency. The trust fund theory is strongly demonstrated also in transferee tax cases. *Price* v. *United States*, 269 U. S. 492, 502; *Phillips* v. *Commissioner*, 42 Fed. (2d) 177, 180.

So too, contrary to Commissioner's contention, in the instant cases this well recognized theory may not be ignored for tax purposes.

The term "proprietary" was not used by this Court in the Letulle case in any restricted or technical sense. Gener-

ally the term connotes ownership, dominion or control. It does not necessarily mean legal title for only the corporation has that until the judicial sale. This Court was referring to the beneficial or equitable interest when it used the term because even stockholders of a solvent corporation have only the beneficial interest in its assets with the right of pro rata distribution thereof upon dissolution, subject to prior claims of creditors. But when a corporation becomes hopelessly insolvent, as was the situation in the instant cases, and the value of the assets are such that only the creditors will participate therein, then at such time even before any formalities of liquidation or foreclosure, it is clear that the creditors have the complete proprietary interest to the exclusion of the stockholders. The stock represents no assets and is valueless. The management of the affairs of the insolvent corporation is thereafter carried on by or on behalf of the creditors. The stockholders as such are without the right to speak. *In re 620 Church Street Corporation*, 299 U. S. 24, 27; *Case* v. *Los Angeles Lumber Company*, 308 U. S. 106; *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510.

Contrary to the Commissioner's contention in this regard in his principal brief in the Southwest Consolidated Corporation case (p. 26) it cannot reasonably be said that until some critical event, such as a foreclosure sale or consummation of a plan under Section 77B of the Bankruptcy Act, the stockholders in an insolvent corporation have the true "proprietary interest" in the sense intended by this Court in the Letulle case. The stockholders in certain rare instances may exercise the empty right of electing officers, but the real management lies in the receiver, committee or other fiduciary acting on behalf of the real beneficial proprietors, the creditors. It is doubtful whether any authority may be found to support the Commissioner's statement that stockholders still have the management, and control for themselves when the facts indisputably establish complete insolvency, and the worthlessness of their stock, before

the "critical event" mentioned by the Commissioner. Moreover, "management" is not always equivalent to "proprietary interest", and the Commissioner does not define his conception of the former term. If stockholders of an insolvent corporation whose shares are worthless by reason of the creditors' claims being in excess of the value of the assets, exercise any rights whatever it is solely by grace of the creditors. In such an event the exercise of such rights must be consistent with and not infringe upon the superior beneficial interests of the creditors. They must act, if at all, at the will of and for the benefit of the creditors.

Actually, the creditors' interests in the instant cases were more than "the anticipation of proprietary interest". The facts in each case show that the creditors, not the stockholders, had the sole right to speak and act with respect to the insolvent's assets. They had the beneficial ownership of the assets before any foreclosure, bankruptcy or receiver's sale, with the right to manage and control the assets and affairs of the corporation either through a receiver or committee acting for them. Possessing these essential elements of proprietorship they formulated plans of reorganization whereby the ultimate goal sought was the continuation of that beneficial or proprietary interest into a new corporate entity formed to receive the legal title and to carry on the business. Their beneficial interest was preserved by controlling stock ownership in the new solvent transferee. Thus the "continuity of proprietary interest" required by this Court from the old to the new corporation meets every essential test.

Point II.

Contention of Taxpayers Here is Consistent with the Intent and Purpose of the Reorganization and Basis Provisions.

The Commissioner has contended throughout the litigation in this series of cases and also contends before this Court that the result of the decisions below in favor of the

taxpayers is to give to the taxpayers tax benefits beyond the intent of the reorganization and basis provisions, because the effect of those decisions is to permit the taxpayers to use for depreciation and other basis purposes, the undepreciated bases of their predecessor corporations.

He apparently sees inequity in the result, because, according to his view, there was an absence of continuity of proprietary interest between the two corporations. Under such a state of affairs, says he, there is no permission in the statute—express or implied—nor is there any equitable or business justification for permitting a new corporation to continue to use the old corporation's basis. He concedes, however, that if there is a continuity of proprietary interest the result would be consistent with the tax laws.

Agreeing that the Commissioner's position might have some merit where no continuity of interest is preserved, nevertheless, we differ with him as to the result and effect of the decisions below in favor of the taxpayers. Instead of giving the taxpayers benefits beyond the intent and purpose of the statutory provisions, they were entirely consistent therewith, giving only what the law intended the taxpayers to have.

It has been generally held that the underlying purpose of the reorganization provisions of the revenue acts is merely to maintain the status quo in tax matters where a transfer is primarily a matter of form and not of substance. *Howard Hotel Corporation*, 39 B. T. A. 1147; *Rex Manufacturing Co. v. Commissioner*, 102 Fed. (2d) 325. That is exactly the result accomplished in the instant cases decided in favor of the taxpayers—the status quo before and after the reorganization was maintained.

Under the rule of the Kitselman and Newberry cases, which we submit are legally sound from a tax standpoint, the entire beneficial interest in the assets of the insolvent predecessor lodged solely in its bondholders or other creditors, was merely preserved under a new corporate form. They became stockholders of a new corporate entity whose enterprise was identical with or an enlargement and con-

tinuation of the predecessor's business operating along the same lines of endeavor and with the same equipment and personnel.

In every material respect the position of the former bondholders or creditors of the predecessors remained unchanged. Their stock holdings in the taxpayers represented in substance the same beneficial interest in the assets as held by them previously in the insolvent predecessors. It is true that under each new corporate set-up with the possible introduction of new capital their positions were at least potentially enhanced, but that was a prospect for the future. At the time of the consummation of the transfer, those former creditors did not in fact gain or lose by their change of status. Their stock in the aggregate acquired the same value as that of the assets transferred and consequently they remained at status quo.

Clearly, no gain or loss resulted to the former bondholders at the time of the transfer; those factors may be considered only at some future period upon the sale or other disposition of the stock they received.[2] This, we submit is the result intended to be achieved by Section 112(b)(3) of the Revenue Act providing for the recognition of no gain or loss where stock or securities in a corporation a party to a reorganization, are exchanged solely for stock or securities in another corporation a party to the reorganization. And where the beneficial interest is represented by bonds or long term obligations of an insolvent corporation, those obligations are "securities" within the meaning of that section. Indeed there is nothing in the Letulle opinion contrary to this rule, since this Court recognized its former holdings that bonds or long term obligations were "securities" within the meaning of the Act. It merely qualified

[2] It should be noted that the holders of millions of dollars in bonds of numerous insolvent corporations have been denied losses by the Commissioner in foreclosure reorganizations such as this on authority of the Kitselman case. Great inequity would now result after the statute of limitations has barred their right to claim such losses, if the Commissioner should be permitted to shift his former position sustained by the 7th Circuit Court and the Board.

such holdings where no proprietary interest is represented by the obligations, i.e., obligations of a solvent transferee.

Further analyzing the situation, it is also clear that the old corporation actually suffered no gain or loss by the transaction. After all the steps in the reorganization were completed its entity, in effect, became merged with that of the taxpayer and its enterprise continued under a mere change of form. The Revenue Act recognizes no gain or loss in such a situation. Here the old corporation was a party to a reorganization under Section 112(g)(2). As such a party to a reorganization, its assets were exchanged in pursuance of a plan of reorganization, solely for stock of another corporation a party to the reorganization. Section 112(b)(4). That provision does not state that the stock of the transferee must go to the transferor corporation itself. The provisions are satisfied if the stock goes to the former beneficial owners of its assets.

Only the stockholders of the old company suffered a loss, by reason of the worthlessness of their stock. But that fact does not negative a statutory reorganization, and is entirely beside the point. The creditors who had the real proprietary interest in the enterprise participated in the plan of reorganization and that interest endured in the final result accomplished. The stockholders did not participate in the reorganization for the simple reason that they had no interest with which to participate.

It is therefore perfectly apparent that no unreasonable tax benefits are conferred upon this taxpayer, nor does any inequity result by assigning to it, as successor in business, the basis for depreciation of its predecessor.

As a practical matter it should be noted that in all of these cases the unused basis of the predecessor for depreciation purposes was less than the original aggregate investment of the participating bondholders or other creditors who became the stockholders in the taxpayer corporation. Consequently the successor corporation through its stockholders gained no unfair advantage by the use of its predecessor's base and the Commissioner's alleged fears of unwarranted results are groundless.

Unique Application of Section 113 (a) (7).

A significant feature in Section 113 (a)(7) of the applicable Revenue Acts should be noted in connection with Commissioner's argument in that part of his principal brief devoted to "Practical Aspects of the Problem." (see pp. 13, 14, Petitioner's brief Southwest Consolidated case). In urging his point that a new cost basis should be adopted for the corporate taxpayer he states, "as a corollary, gain or loss will be recognized upon the exchange of the claims for stock of the new company since Section 112 (b)(3) will be inapplicable." Thus the Commissioner urges that since these reorganizations will not be tax-free reorganizations to the old creditors, the basis provision of Section 113 (a)(7) will not apply. Conveniently now for his present purpose Commissioner argues that his position in the *Kitselman* case was wrong.

But the Commissioner's reasoning does not necessarily follow merely because these reorganizations may be taxable to the security holders, if they are still within the terms of reorganization definitions in Section 112 (g).

Section 113 (a)(7) requires that property must be acquired by a corporation "in connection with a reorganization," etc. It is especially to be noted that it need not be a "tax-free" reorganization. Therefore, even though a transaction may not be tax-free with respect to the participants, the acquiring corporation may still be entitled to the basis of is predecessor under Section 113 (a)(7) provided the conditions as to control are met and the transaction is embraced within one or more of the definitions in Section 112 (g)(1). See in this connection *National Bank of Commerce of Seattle*, 40 B. T. A. 72, 77 aff'd. (C. C. A. 9th), 115 Fed. (2d) 875; *Muskegon Motor Specialties Co.*, decided November 4, 1941, 45 B. T. A. No. 91; and comment in 1942 C. C. H. Tax Service para. 778.01, where it is stated that transfers made in connection with reorganizations (even though not tax-free reorganizations) come within the meaning of Section 113 (a)(7).

Clearly, therefore, the Commissioner's comments as to recognizable gains or losses to the security holders are beside the point even if he may be right. Regardless of the tax effect on the participants or nonparticipants in the reorganization, the present corporate taxpayers are entitled to the bases of their predecessors under Section 113 (a)(7) if the other conditions of that Section are met, and each transaction comes within one or more of the definitions in Section 112 (g)(1).

It is not the province of this Brief Amicus Curiae to go into the varying elements regarding the compliance of each of these cases to the requirements of Sections 113 (a)(7), 112 (g)(1) of the 1934 and comparable provisions in other applicable Acts. Suffice it is to say that adequate and convincing discussion of these features appear in the several briefs of taxpayers filed herein, and we submit that those requirements were met, thus entitling the taxpayers to the bases of their defunct corporate predecessors.

Incidentally, it may be noted that the Commissioner in some of the instant cases attempted to destroy literal compliance with Clause B of Section 112(g)(1) of the 1934 Act (see Petitioner's principal brief in Southwest Consolidated Case, p. 21) by stating that the assets were not acquired solely for voting stock when such was actually the case. His claim is that "by hypothesis cash for dissenters * * * were also exchanged". But an examination of the records of each of the instant cases on consolidated hearing as well as of those pending this Court's action on petitions for writs of certiorari, disclose that either the dissenters were paid off by the cash raised by the "bondholders Committees",[3] or the payments of dissenters were obtained by loans which the acquiring corporations assumed. Under the retroactive 1939 amendment to Section 112(g)(1) the assumption of such an obligation was to be disregarded in

[3] This was the situation in *Helvering* v. *New Haven and Shore Line Railway Co.*, No. 780, now pending this Court's action. That case literally complied with Section 112(g)(1)(B) and Section 113(a)(7). See opinion of C. C. A. 2nd below, 121 Fed. (2d) 985.

determining whether the exchange was "solely" for voting stock (see comments in this regard Respondent's Brief, p. 15, Southwest Consolidated Case). Clearly the new requirement of Section 112(g)(1)(B) of the 1934 Act was satisfied in the cases governed by that Act now before this Court.

CLOSING STATEMENT.

The argument of the Commissioner in the instant cases, in effect, is that the taxpayers' bases for depreciation are to be governed completely by technical formalities incident to ordinary mortgage foreclosure proceedings or the like instituted by secured creditors of defunct corporations in *liquidation* of their affairs. In the opinion of amicus curiae, this contention is untenable in that it ignores the plain facts that the impelling motives in these cases were the desires to perpetuate rather than liquidate the businesses and that bondholders or other creditors' protective committees pursuant to preconceived plans of reorganization took all of the necessary steps towards that end, namely, the reorganization of an unsound corporate structure for the purpose of continuing a business enterprise.

Except for a few dissenters it was not a situation where a group of individual creditors desired to salvage what they could get from a bad investment, leaving the residue, if any, to the stockholders. In such a case it well may be argued that their aims could have been fulfilled by a pro rata distribution of the proceeds of the foreclosure or other sale. Instead, we have a situation where the creditors have banded together under the leadership of a formal committee interested only in continuing the business under a new corporate set-up and by a pre-conceived pattern of effort have taken all essential steps to that end.

Throughout the Commissioner's briefs in the instant cases is plainly the central theme that a proprietary inter-

est in corporate property means only shareholder interest. Plainly the proprietary interest in corporate property may take other forms than shareholder interest, especially when the corporation is insolvent and its stock worthless. Under such circumstances, stockholders have lost their proprietary interest to the creditors before any foreclosure or other judicial sale of the assets. The beneficial interest immediately vests in the creditors and a subsequent foreclosure sale merely transfers the bare legal title to the assets vested in the defunct corporation.

Clearly this situation reduced to these fundamentals satisfies the statutory definition of reorganization in Section 112 (g)(1) and the basis provisions of Section 113 (a)(7). The latter provision is concerned with "interest or control" remaining in the same persons or any of them immediately after the transfer. The term "interest" is a much broader term than ownership and would embrace any persons who have the ultimate beneficial rights in the property both before and after the transfer. Unquestionably, the bondholders or other creditors as beneficiaries of the trust fund had those ultimate beneficial rights in the property of each insolvent corporation and retained those rights by stock ownership in the required percentages immediately after the transfer. If Congress had meant to limit the word "interest" to "stockholder" interest, it would have used that word.

CONCLUSION.

Consideration of all of these factors demonstrates the errors in the argument of the Commissioner as well as in the opinions of the Ninth Circuit Court of Appeals in the Marlborough House and Palm Springs Holding Corporation cases, and discloses such a different situation from that prevailing in the Letulle case that, fully recognizing the "continuity of proprietary interest" rule therein enunciated, it

is still clear that the language therein employed does not have any governing application in the instant cases.

All of which is respectfully submitted.

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FEB 21 1942

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR REHEARING

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IN THE

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No. 286

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

PETITION FOR REHEARING

TO THE HONORABLE JUSTICES OF THE UNITED STATES SUPREME COURT:

Respondent respectfully prays for a rehearing of this case, decided February 2, 1942, for the following reasons:

1. The Court held that basis was not cost to the old company because the transaction did not qualify as a "reorganization" under Sec. 112 (g) (1) of the 1934 Revenue Act. On February 9, 1942 the Court denied certiorari in the cases of *Commissioner* v. *Cement Investors, Inc.* and others, Nos. 644-646. In those cases the Tenth Circuit had held that a plan similar to the one here (although there income bonds as well as warrants were issued by the new company) *was* a "reorganization" under Sec. 112 (g) (1) of the 1936 Revenue Act. That statute is identical with the statute applicable here.

Presumably, the Court denied certiorari because the Tenth Circuit also found that the old bondholders had no recognizable gain or loss under Sec. 112 (b) (5) of the 1936 Act. That is, it is to be inferred this Court considered it unnecessary to pass on the *Cement Investors* and related cases because, while this Court presumably thought there was no "reorganization" there, this Court also thought the bondholders there had no gain or loss under Sec. 112 (b) (5), as the Circuit Court had concluded.

This approach makes it necessary, we submit, for the Court to reconsider its decision in this case because, if Sec. 112 (b) (5) is applicable to the exchange by the bondholders, under Sec. 113 (a) (8) of the 1934 Act the basis of the new company here is the cost to the old company, *and the decision of the Fifth Circuit should have been affirmed.*

In the *Cement Investors* and related cases the Commissioner claimed Sec. 112 (b) (5) was not applicable.[1] Likewise, the Commissioner claimed that Sec. 112 (b) (5) and the correlative basis provision, Sec. 113 (a) (8), was not applicable here.[2] The Commissioner's position on this point in this case is unsound for the following reasons:

Sec. 113 (a) (8) provides that if property is acquired by a corporation "in connection with a transaction described in Sec. 112 (b) (5)," then the basis shall be the same as it would be in the hands of the transferor. The taxpayer here acquired its assets "in connection with" the exchange by the bondholders, other claim-holders and stockholders of the old company of their old securities for the stock and stock purchase warrants of the taxpayer. The Tenth Circuit in the *Cement Investors* case found such a transaction to be within Sec. 112 (b) (5). If so, the

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[1] See the Commissioner's Petition for Certiorari in those cases.

[2] See Brief for Petitioner in No. 286, at page 24.

taxpayer here acquired its assets "in connection with a transaction described in Sec. 112 (b) (5)," and under Sec. 113 (a) (8) the basis of the taxpayer is the same as it would be in the hands of the "transferor." This Court found that the separate steps of the plan here are to be disregarded and the plan is to be treated as a single reorganization. So considered, the "transferor" was the old company. See *George A. Whittell & Co., Inc.*, 34 B. T. A. 1070.

The Board and the courts, in upholding the Commissioner, have similarly interpreted the corresponding term "in connection with a reorganization" contained in Section 113 (a) (7). *Piedmont Financial Company, Inc.*, 26 B. T. A. 1221.[3] In that case corporation A acquired all of the stock of corporation B (which was a "reorganization"), and subsequently liquidated B. The question was the basis to A for B's assets. The Board held that under Sec. 204 (a) (7) of the 1926 Revenue Act (corresponding to Sec. 113 (a) (7) of the 1934 Revenue Act) A's cost was the same as cost to B, saying (p. 1224):

> "* * * section 204 (a) (7) is not limited to property acquired in a tax-free reorganization, but includes property 'acquired in connection with a reorganization.'"

Likewise, if property is "acquired in connection with a transaction described in section 112 (b) (5)," basis is cost to transferor under Sec. 113 (a) (8).

Therefore, on the basis of the Tenth Circuit's decision in the *Cement Investors* case, which this Court has not

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[3] Cases to the same effect are *Monte & Co.*, 24 B. T. A. 401; *Flushing Nurseries Co.*, 25 B. T. A. 938; *Ahles Realty Corp.*, B. T. A. Memo., Dec. 28, 1932, aff'd. (C. C. A. 2) 71 F. (2d) 150, certiorari denied, 293 U. S. 611.

reversed; this Court should have affirmed the Fifth Circuit's decision here.[4]

2. The denial of certiorari in the *Cement Investors* and related cases, following the decision in this case, has created the utmost confusion as to what is the law in these matters. There is set forth in the Appendix an article appearing in "The Wall Street Journal," February 10, 1942, p. 2, which illustrates the doubt and uncertainty which have been created. Numerous companies are left in a quandary as to their tax position. It is impossible to determine the tax status of many pending and recently completed railroad reorganizations.[5] There is the most

[4] On February 9, 1942 the Court also denied certiorari in *Helvering* v. *New Haven & Shore Line Railway Co., Inc.*, No. 780. Such action would seem to be explicable only on the basis of some peculiarity in that record. There, as here, some of the bondholders did not participate in the plan and were paid off in cash. The Court in this case found that was enough to take the transaction out of the B definition of "reorganization". As the matter now stands, most attorneys, in all probability, will find it wholly impossible to reconcile the decision in this case with the denial of certiorari in the *New Haven* case. See Appendix.

[5] See "The Wall Street Journal," Feb. 3, 1942, p. 2; Feb. 4, 1942, p. 5; "The New York Times," Feb. 4, 1942, p. 27.

In "Outlook for the Security Markets," February 16, 1942, p. 928 (published by Standard & Poor's Corporation), appears the following:

> "Defaulted rail bonds showed some improvement following Supreme Court action on appeal in a corporate reorganization case suggesting that railroads which reorganized under section 77 could use their predecessor companies' invested capital as a base for calculating excess profits tax exemption. The action was in the form of a refusal to review a Court of Appeals decision and was without opinion; since it has previously taken action which might suggest the opposite conclusion, the issue remains to be clarified by a specific railroad reorganization case or a full opinion."

urgent need for clarification, and to that end a rehearing should be granted. The situation is truly important and transcends any considerations against granting a rehearing which might exist in the ordinary case.

3. The positions taken by the Court in the opinion rendered (1) that the plan should be treated as unitary and (2) that the statute should be given a strict literal interpretation, bring the decision here in conflict with a line of recent decisions of this Court.

The Court has held that where the assets of one corporation are transferred to another in consideration for a payment by the transferee directly to the owners of the transferor, for tax purposes such consideration is deemed to pass through the transferor corporation. *United States* v. *Joliet & Chicago Railroad Co.*, decided January 19, 1942; *United States* v. *Boston & Maine R. Co.*, 279 U. S. 732. And if, as here, the consideration is stock of the transferee, there is a stock transfer tax on a transfer of the right to receive such stock from the transferor corporation to its stockholders. *Raybestos-Manhattan, Inc.* v. *United States*, 296 U. S. 60.

Thus, under the decision rendered in this case and the above line of cases, the stock and warrants of the taxpayer here must be deemed to have gone, *first*, to the old corporation, and *thereafter* to have been distributed by it to its bondholders, claim-holders and stockholders, in accordance with the plan.

The result is that the transaction qualifies under the C definition of a "reorganization" in Sec. 112 (g) (1), since "*immediately* after the transfer the transferor" corporation owned all of the stock of the taxpayer, and therefore was "in control" of the taxpayer.

A strict interpretation of the word "immediately" in the C definition is required by the Court's decision. The Court has found that the word "solely" in the B definition "leaves no leeway." The rule of interpretation applied to one definition should likewise be applied to the other.

4. The Court found that the E definition of "reorganization" was inapplicable, on the theory that the transaction shifted "the ownership of the proprietary interest." But in the *Alabama Asphaltic* case the Court said that "for practical purposes" the shift took place "not later than the time when the creditors took steps to enforce their demands." Further:

> "When the equity owners are excluded and the old creditors become the stockholders of the new corporation, it conforms to realities to date their equity ownership from the time when they invoked the processes of the law to enforce their rights of full priority. At that time they stepped into the shoes of the old stockholders. The sale 'did nothing but recognize officially what had before been true in fact.' *Helvering* v. *New Haven & S. L. R. Co.*, 121 F. (2d) 985, 987."

We earnestly submit that if "for practical purposes" the situation after the transfer to the new company was the same as it was immediately before the transfer, and if the plan merely gave legal effect to "what had before been true in fact" then, consistently, the transaction was "a mere change in identity, form, or place of organization," as provided in E. The E definition reflects the fundamental principle that in tax matters substance and not form controls. The application of such principle in the interpretation of the E definition is particularly apt.

WHEREFORE, it is prayed that the Court grant a rehearing of this case.

Respectfully submitted,

A. CHAUNCEY NEWLIN,
FRED SIMON,
Attorneys for Respondent.

I certify that this petition is presented in good faith and not for delay.

A. CHAUNCEY NEWLIN,
Attorney for Respondent.

February 1942.

Appendix

From "The Wall Street Journal", February 10, 1942, p. 2.

"Top-Notch Lawyers Paw the Air After More Supreme Court Rulings on Taxability of Reorganized Firms.

"By Eugene S. Duffield
"Staff Correspondent of The Wall Street Journal

"Washington—The Supreme Court yesterday left in a fog the taxability of companies which have been reorganized.

"Through this fog gleams one dim hope that railroads and other companies which have been reorganized under Section 77 of the Bankruptcy Act may be treated for tax purposes more leniently than companies which have passed through receivership and foreclosure sales.

"If railroads going through the Section 77 process are recognized as 'reorganized' companies under tax law definitions, they can use the property valuations of their predecessor companies for tax computations, thus obtaining larger deductions for depreciation and for excess profits tax purposes.

"However, the only certainty yesterday was that tax lawyers in and out of the government were completely uncertain about the court's application of tax laws to corporate reorganizations.

"In the past eight days the Supreme Court has handed down four opinions and five orders, all in answer to the single question: When is a corporation 'reorganized' within the meaning of the tax laws?

"Court May Be Asked for Clarification

"The usual result of Supreme Court decisions—in fact, the chief purpose for which litigants seek them—is clarification of the law. Yet these nine actions by the court on

the taxability of reorganized companies have left top-notch lawyers pawing the air. Nobody agrees on what the court has done or why it has done it. Indications are that the Government will ask the court to explain itself.

"*Some Case Histories*

"A recital of the facts in three of the nine cases, all of which involve the definition of 'reorganized' companies contained in Section 112 (G) of the revenue laws, shows why tax lawyers are confused. Here are the facts in one case:

"1. The predecessor of Southwest Consolidated Corp. defaulted on its bonds. Receivers were appointed. After a plan of reorganization had been worked out, the company's assets were sold at foreclosure sale to the bondholders protective committee.

"2. In exchange for these assets, the bondholders of the old company received the voting stock of the new Southwest Consolidated Corp.

"3. The stockholders of the old company received nothing but warrants permitting them to purchase stock in the new company.

"This is not a reorganization under any of the definitions of Section 112 (G) of the revenue laws, says the court. So far, so good. Now here are the facts in a second case:

"1. The predecessor company, Colorado Industrial Co. defaulted on its bonds and filed a petition for reorganization under Section 77B of the Bankruptcy Act.

"2. Under the reorganization plan bondholders in the old company received income bonds and voting stock in a new company.

"3. The stockholders in the old company received nothing but warrants permitting them to purchase stock in the new company.

"This *is* a reorganization within Section 112 (G) of the revenue act, said a majority of the Tenth Circuit Court, and yesterday the Supreme Court declined to review the circuit court's opinion.

"*There's a Difference But—*

"How does it differ from the Southwest case? There is one obvious difference. The second case (known as the Cement Investors Case) came under section 77B whereas the Southwest case did not. Some lawyers believed that single point made all the difference. Other lawyers said flatly that they thought it made no difference.

"One lynx-eyed barrister pointed out that the Circuit Court had upheld the second case under Section 112 (B)(5) as well as Section 112 (G) of the Revenue Act. He surmised that the Supreme Court had agreed with the lower court on the Section 112 (B) (5) angle—which was not involved in the Southwest case—but had not agreed on the Section 112 (G) point.

"'O, no,' objected another lawyer, 'if they were going to do anything as subtle as that, they would write an opinion about it.'

"*Now Mystery Deepens*

"At least there is room for argument over why these two cases should be decided differently. But now the mystery deepens. Look again at the facts in the Southwest case, and remember that the Court held these facts do not constitute a reorganization under the revenue acts. Now check these facts against the following facts in a third case:

"1. The New Haven & Shore Line Railway defaulted on its bonds. Receivers were appointed. After a plan of reorganization had been worked out, the old company's assets were sold at foreclosure sale to the bondholders protective committee.

"2. In exchange for these assets, the bondholders of the old company received the capital stock of the new company.

"3. The stockholders of the old company received nothing—a fact which everyone concedes makes no difference.

"The Circuit Court held that this *is* a reorganization under the definitions in Section 112 (G) of the Revenue Act, and the Supreme Court yesterday refused to review this decision. How does this differ from the Southwest case? The Court did not say.

"Lovers of mysteries are free to puzzle over these three cases until the Court deigns to speak again—and more clearly."

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

SECOND PETITION FOR REHEARING

A. CHAUNCEY NEWLIN,
FRED SIMON,
Attorneys for Respondent.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1941

No. 286

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

SECOND PETITION FOR REHEARING

TO THE HONORABLE JUSTICES OF THE UNITED STATES SUPREME COURT:

Respondent respectfully moves the Court to reconsider its decision in this case, in connection with its consideration of *Helvering* v. *Cement Investors, Inc., Commissioner* v. *Newton Trust,* and *Commissioner* v. *Newton, Jr.,* Nos. 644, 645 and 646, respectively, and to supplement its opinion in this case by passing on the question of the applicability to this case of Sections 112 (b) (5) and 113 (a) (8) of the Revenue Act of 1934, c. 277, 48 Stat. 680.

Presumably, disposition of the *Cement Investors* and *Newton* cases will entail a determination by this Court of

the applicability of Section 112 (b) (5) and 113 (a) (8) to insolvency reorganizations carried out after the effective date of the Revenue Act of 1934 (January 1, 1934). The applicability of those sections to the instant case has been argued to the Court by both the Commissioner (Petitioner's Brief, p. 24) and the taxpayer (Petition for Rehearing, pp. 1-3) but the Court has not passed on the point. The Government in the oral argument of the *Cement Investors* and *Newton* cases and in its briefs in those cases has stated its position as to the applicability of those sections to the instant case should they be held applicable in the *Cement Investors* and *Newton* cases.

The Court is aware of the importance of the question of the basis of the multitude of new corporations created in insolvency reorganizations carried out since the enactment of the Revenue Act of 1934. It is most desirable that the issue be settled. Thus far the Court has decided only the question of the applicability of Section 113 (a) (7). It has not passed on the question of the applicability of Section 113 (a) (8). We earnestly urge the Court not to leave the matter in such a state where it may be necessary to litigate all over again the question of the applicability of Section 113 (a) (8). It is within the power of the Court to avoid this result. In so doing it is not necessary for it to change its views as to the applicability of Section 113 (a) (7). It is necessary only for it to amplify its opinion by passing on the question of the applicability of Section 113 (a) (8).

We respectfully suggest to the Court that it issue a supplemental opinion in this case on that point. Whatever hesitancy the Court might feel in so doing, we submit, should be overcome by the thought that in settling this question now the Court will be preventing further and per-

haps long continued confusion in the administration of the law, and will be acting in the best interests of all parties concerned.

Respectfully submitted,

A. CHAUNCEY NEWLIN,
FRED SIMON,
Attorneys for Respondent.

I certify that this petition is presented in good faith and not for delay.

A. CHAUNCEY NEWLIN,
Attorney for Respondent.

April 1942.

FILE COPY

No. 286

IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1941

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

MEMORANDUM IN SUPPORT OF SECOND PETITION FOR REHEARING

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AMERICAN BRIEF AND RECORD CO., GRAND RAPIDS, MICHIGAN

No. 286

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October Term 1941

GUY T. HELVERING, Commissioner of Internal Revenue,
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v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

MEMORANDUM IN SUPPORT OF SECOND PETITION FOR REHEARING

To the Honorable Justices of the United States Supreme Court:

Leave is respectfully requested to file this short memorandum in support of the respondent's second petition for rehearing.

I represent Grand Rapids Store Equipment Company, a corporation which was reorganized in a general equity receivership in the District Court of the United States for the Western District of Michigan. A plan of reorganization in that case had progressed to the point where the plan had been approved by court order, a judicial sale had been held, the assets had been bid in by a reorganization committee, and the sale had been confirmed by court order before December 31, 1933. The economic burdens and benefits of ownership were transferred in 1933. However, due to the amount of detail confronting

the Master in Chancery, the conveyances were not actually delivered until January 19, 1934.

In conferences with representatives of the Treasury Department the question has already been provoked whether the reorganization was consummated in 1933, or whether it was completed after the effective date of the Revenue Act of 1934, and upon the decision of that question hangs the right of the reorganized corporation to use the basis of its assets in the hands of the predecessor corporation. Cf. *Helvering vs. Alabama Asphaltic Limestone Co., Palm Springs Holding Corporation vs. Commissioner, Helvering vs. Southwest Consolidated Corporation*, decided February 3, 1942.

It has come to my attention that in the presentation of the cases of *Helvering vs. Cement Investors, Inc.; Commissioner vs. Newton Trust, and Commissioner vs. Newton, Jr.*, Nos. 644, 645, and 646, this court has been asked to determine the applicability of Sections 112 (b) (5) and 113 (a) (8) to reorganizations under Section 77 B of the Bankruptcy Act consummated after the effective date of the 1934 Revenue Act, January 1, 1934. It is respectfully submitted that there is no proper distinction between reorganizations under Section 77 B of the Bankruptcy Act and other types of reorganizations in so far as the applicability of Sections 112 (b) (5) and 113 (a) (8) I. R. C. is concerned.

If this court in its decision in the *Cement Investors* and *Newton* cases decides the question of applicability in favor of the taxpayer, then it seems clear that such a decision should also be made in the above entitled cause.

Such a decision would immediately break down the barrier between reorganizations consummated prior to January 1, 1934 and those completed thereafter, and would obviate much expensive litigation in the case of those reorganizations which happened to be pending in some stage or other of completion at the effective date of the 1934 Revenue Act as is the case of the Grand Rapids Store Equipment Company.

This honorable court is respectfully urged to grant the requested rehearing in the above entitled cause, and to dispel the doubt and inevitable dissension between taxpayers and the government which will continue until the applicability of Sections 112 (b) (5) and 113 (a) (8) in cases other than bankruptcy reorganizations has been settled by the decision of this court.

Respectfully submitted,

ROBERT C. C. HEANEY,
Amicus Curiae.
McCOBB & HEANEY,
Of Counsel.

April 30, 1942.

p.4

SUPREME COURT OF THE UNITED STATES.

No. 286.—October Term, 1941.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Southwest Consolidated Corporation.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[February 2, 1942.]

Mr. Justice Douglas delivered the opinion of the Court.

The primary problem in this case is whether the transaction in question qualified as a "reorganization" under § 112(g)(1) of the Revenue Act of 1934. 48 Stat. 680, 705. Sec. 112(g) provides:

"As used in this section and section 113—

"(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected."

Respondent filed an income and excess profits tax return for a part of the year 1934 and for the entire year 1935, reporting a net loss for each year. Petitioner, in determining deficiencies, made certain adjustments on the theory that the acquisition by respondent in 1934 of all of the assets of its predecessor, Southwest Gas Utilities Corp., was not a "reorganization" as defined in § 112(g)(1). The cost basis of the assets in the hands of the old corporation had been about $9,000,000. They were purchased at foreclosure and receivership sales for $752,000. Respondent used the former figure as the basis in computing gains and losses on the acquired assets. Thus it deducted some $75,000 as bad debts. Petitioner in using the lower figure as the basis allowed that deduction only to the extent of $1.26. Deficiencies computed on that

theory showed a net income, rather than a net loss, for each year. The Board of Tax Appeals rejected the Commissioner's view.[1] The Circuit Court of Appeals affirmed the judgment of the Board. 119 F. 2d 561.

The old corporation was burdened with some $2,870,000 face amount of first lien bonds, certain unsecured claims, and issues of preferred and common stock. There was a default in interest on the bonds in May, 1932. A bondholders' committee was formed which obtained the deposit of about 85% of the bonds outstanding. Members of the committee became directors of the old corporation and beginning in the fall of 1932 were in control of it. In 1934 equity receivers were appointed by the Delaware chancery court. A plan of reorganization was formulated which was approved by the court. The plan called for the formation of a new company which would acquire the assets of the old in exchange for voting common stock and Class A and Class B stock purchase warrants. Most of the common stock, issued under the plan, was to go to the bondholders; a small portion, together with the Class A warrants, was to be issued to the unsecured creditors. Class B warrants were to be issued to the preferred and common stockholders. Pursuant to the plan and a court order, the assets securing the bonds were sold by the indenture trustee at a foreclosure sale in 1934. They were bid in by the bondholders' committee for $660,000. The unpledged assets also were sold at public auction and were bought in by the committee for $92,000. Respondent was thereupon formed and the committee transferred all the assets of the old corporation to it. The Board found that the fair market value of the assets at that time was $1,766,694.98. The stock and warrants of respondent were distributed pursuant to the plan. Non-participating security holders, owning $440,000 face amount of obligations, received about $106,680 in cash. The cash necessary to make this payment was obtained by a loan from a bank. The loan was assumed by the respondent and later repaid by it. About 49,300 shares of common stock and 2,760 Class A warrants were issued to the creditors; over 18,445 Class B warrants were issued to the stockholders. Class A warrants carried the right to

[1] The petition for review by the taxpayer contended that this transaction was a "reorganization" within the purview of § 112(g)(1) and therefore that the carry-over basis provided in § 113(a)(7) was applicable. No other issues were raised or considered by the Board or the court below. We pass only on that question leaving open such other questions as may be appropriately presented to the Board.

buy one share of common stock at $6 a share during 1934, the price being increased $1 per share each year until expiration in 1938. Class B warrants carried the same right except that the price was $10 a share during 1934 and was increased by $5 per share each year until expiration in 1938. There were 1,760 Class A warrants and 4,623 of the Class B warrants exercised. On the basis of the fair market value of the assets at the time they were acquired in the reorganization, respondent computes that the Class A warrants had a value of $29 each and the Class B warrants a value of $25 each.

Under the statute involved in *Helvering* v. *Alabama Asphaltic Limestone Co.*, No. 328, decided this day, there would have been a "reorganization" here. For the creditors of the old company had acquired substantially the entire proprietary interest of the old stockholders. See *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378. But clause B of § 112(g)(1) of the 1934 Act effects an important change as respects transactions whereby one corporation acquires substantially all of the assets of another. See S. Rep. No. 558, 73d Cong., 2d Sess., Committee Reports, Revenue Acts 1913-1938, pp. 598-599. The continuity of interest test is made much stricter. See Paul, Studies in Federal Taxation (3rd Series), pp. 36-41. Congress has provided that the assets of the transferor corporation must be acquired in exchange "solely" for "voting stock" of the transferee. "Solely" leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement. See Hendricks, Developments in the Taxation of Reorganizations, 34 Col. L. Rev. 1198, 1202-1203. Congress, however, in 1939 amended clause B of § 112(g)(1) by adding, "but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded." 53 Stat. 871. That amendment was made to avoid the consequences of *United States* v. *Hendler*, 303 U. S. 564. See H. Rep. No. 855, 76th Cong., 1st Sess., pp. 18-20; S. Rep. No. 648, 76th Cong., 1st Sess., p. 3. And it was made retroactive so as to include the 1934 Act. 53 Stat. 872. But with that exception, the requirements of § 112(g)(1)(B) are not met if properties are acquired in exchange for a consideration other than, or in addition to, voting stock. Under that test this transaction fails to qualify as a "reorganization" under clause B.

In the first place, security holders of the old company owning $440,000 face amount of obligations were paid off in cash. That cash was raised during the reorganization on a loan from a bank. Since that loan was assumed by respondent, it is argued that the requirement of clause B, as amended in 1939, was satisfied. But in substance the transaction was precisely the same as if respondent had paid cash plus voting stock for the properties. We search the legislative history of the 1939 amendment in vain for any indication that it was designed to do more than to alter the rule of the *Hendler* case. That case dealt with a situation where an indebtedness which antedated the transaction in question was assumed by the transferee. There the debt assumed clearly was a "liability of the other" corporation. The situation here is quite different. The rights of the security holders against the old corporation were drastically altered by the sale made pursuant to the plan. The sale not only removed the lien from the property and altered the rights of the security holders in it; it also limited and defined the rights of the individual creditors if they elected to take cash rather than participate in the plan. See Weiner, Conflicting Functions of the Upset Price, 27 Col. L. Rev. 132, 137-138. In *Helvering* v. *Alabama Asphaltic Limestone Co.*, *supra*, we regarded the several steps in a reorganization as mere "intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan." Under that approach part of the consideration which respondent paid for the properties of its predecessor was cash in the amount of about $106,680. The fact that it was paid to the bank rather than to the old corporation or its creditors is immaterial. The requirement to pay cash arose out of the reorganization itself. It derived, as did the requirement to pay stock, from the plan pursuant to which the properties were acquired. It was a necessary incident of the court decree which wiped out the liability of the old corporation and substituted another one in its place. Though the liability assumed had its origin in obligations of the transferor, its nature and amount were determined and fixed in the reorganization. It therefore cannot be labelled as an obligation of the "other" or predecessor corporation within the meaning of the 1939 amendment. Nor can the property be said to have been acquired "subject to" that liability within the purview of that amendment. The words "subject

to" normally connote in legal parlance an absence of personal obligation. That seems to be the case here, for the preceding clause of the amendment covers the case of "assumption".

In the second place, the warrants which were issued were not "voting stock". Whatever rights a warrant holder may have "to require the obligor corporation to maintain the integrity of the shares" covered by the warrants (see Berle, Studies in the Law of Corporation Finance (1928), pp. 136-142) he is not a shareholder. *Gay* v. *Burgess Mills*, 30 R. I. 231. Cf. *Miles* v. *Safe Deposit Co.*, 259 U. S. 247, 252. His rights are wholly contractual. As stated by Holmes, J., in *Parkinson* v. *West End Street Ry.*, 173 Mass. 446, 448, he "does not become a stockholder by his contract in equity any more than at law." At times his right may expire on the consolidation of the obligor corporation with another. *Id.* If at the time he exercises his right there are no authorized and unissued shares to satisfy his demand, he will get damages not specific performance. *Bratten* v. *Catawissa Railroad Co.*, 211 Pa. 21. And see *Van Allen* v. *Illinois Central Railroad Co.*, 7 Bosw. 515. Thus he does not have, and may never acquire, any legal or equitable rights in shares of stock. *Lisman* v. *Milwaukee, L. S. & W. Ry. Co.*, 161 Fed. 472, 480, aff'd 170 Fed. 1020. And he cannot assert the rights of a shareholder. See Hills, Convertible Securities, 19 Calif. L. Rev. 1, 4. Accordingly, the acquisition in this case was not made "solely" for voting stock.[2] And it makes no difference that in the long run the unexercised warrants expired and nothing but voting stock was outstanding. The critical time is the date of the exchange. In that posture of the case it is no different than if other convertible securities had been issued, all of which had been converted within the conversion period.

Nor can this transaction qualify as a "reorganization" under clause C of §112(g)(1). That clause requires that "immediately after the transfer" the "transferor or its stockholders or both" be in "control" of the transferee corporation. "Control" is defined in §112(h) as "the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." Here "control" at the critical date was not in the old corporation or its "stockholders". The participating creditors had received pur-

[2] The contrary view expressed in a letter by the Commissioner dated January 27, 1937 (1937 C. C. H. Vol. 3, Par. 6118) does not have the status of a formal ruling of the Treasury nor does it seem to reflect an established course of administrative construction.

suant to the plan rights to receive over a majority of the stock of the new company even though all of the warrants allocated to stockholders had been issued and exercised. The contrary conclusion was reached in *Commissioner* v. *Cement Investors, Inc.*, 122 F. 2d 380, 384, on the theory that the bondholders of the insolvent predecessor company could be regarded as its "stockholders" within the meaning of § 112(g)(1)(C), since they had acquired an equitable interest in the property and were empowered to supplant the stockholders. We have adopted that theory in *Helvering* v. *Alabama Asphaltic Limestone Co., supra*, in determining whether the bondholders had retained a sufficient continuity in interest so as to bring the transaction within the statutory definition of merger or consolidation contained in the revenue acts prior to 1934. But it is one thing to say that the bondholders "stepped into the shoes of the old stockholders" so as to acquire the proprietary interest in the insolvent company. It is quite another to say that they were the "stockholders" of the old company within the purview of clause C. In the latter Congress was describing an existing, specified class of security holders of the transferor corporation. That class, as we have seen, received a participation in the plan of reorganization. For purposes of clause C they must be counted in determining where "control" over the new company lay. They cannot be treated under clause C as something other than "stockholders" of the old company merely because they acquired a minority interest in the new one. Indeed clause C contemplates that the old corporation or its stockholders, rather than its creditors, shall be in the dominant position of "control" immediately after the transfer and not excluded or relegated to a minority position. Plainly the normal pattern of insolvency reorganization does not fit its requirements.

Clause D is likewise inapplicable. There was not that reshuffling of a capital structure within the framework of an existing corporation contemplated by the term "recapitalization". And a transaction which shifts the ownership of the proprietary interest in a corporation is hardly "a mere change in identity, form, or place of organization" within the meaning of clause E.

Reversed.

Mr. Justice ROBERTS did not participate in the consideration or decision of this case.